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Date: 2/6/2006

By: Reborah A. Mc

**IN THE UNITED STATES PATENT AND TRADEMARK OFFICE**

**PATENT**

Inventors:	Crane, et al.	Docket No.:	49335.0300 (fka 10655.7700)
Serial No.:	09/415,632	Examiner:	Poinvil, Frantzy
Filed:	October 12, 1999	Group Art Unit:	3628
Title:	SYSTEM AND METHOD FOR DIVIDING A REMITTANCE AND DISTRIBUTING A PORTION OF THE FUNDS TO MULTIPLE INVESTMENT PRODUCTS		
		Confirmation No.:	5093

**INVENTORS' SUPPLEMENTAL DECLARATION UNDER 37 C.F.R. § 1.131**

Mail Stop Amendment  
Commissioner for Patents  
P.O. Box 1450  
Alexandria, Virginia 22313-1450

Dear Commissioner:

We, the undersigned inventors, declare as follows:

1. This declaration establishes conception of the invention in this application in the United States, at a date prior to November 27, 1996, which is the effective filing date of U.S. Patent No. 6,070,153 issued to Simpson, which was cited in the Final Office Action dated May 19, 2005, coupled with due diligence from prior to said date to the subsequent filing of the application on October 12, 1999.
2. We are the inventors of the subject matter described and claimed in United States Patent Application Serial No. 09/415,632, filed October 12, 1999, entitled SYSTEM AND

METHOD FOR DIVIDING A REMITTANCE AND DISTRIBUTING A PORTION OF THE FUNDS TO MULTIPLE INVESTMENT PRODUCTS, and we originally assigned our rights to the invention to assignee's predecessor, American Express Travel Related Services Company, Inc. ("AMEX").

3. To establish the date of conception of the invention of this application, the attached Willkie Farr & Gallagher Memorandum dated September 14, 1990 ("Willkie Memo") is submitted as evidence and is attached herewith as Exhibit 1. From this document, it can clearly be seen that the invention in this application was conceived at least by the date of September 14, 1990, which is a date much earlier than the effective filing date of the cited Simpson reference (i.e., November 27, 1996). The Willkie Memo bears a September 14, 1990 date in the third line of the header information and the Willkie Memo was drafted by Willkie Farr & Gallagher, a large, established law firm with offices throughout the World.
4. The Willkie Memo resulted from a request by AMEX to its law firm to address the legal issues arising under the federal securities laws in connection with offering its cardmembers the opportunity to invest in investment products via an investment broker system through payments on their charge cards via a charge card billing system, utilizing a hierarchy of distribution rules.
5. Applicant never abandoned this invention, and Applicant exercised reasonable diligence from prior to September 14, 1990, to the filing of the above-identified patent application.
6. After receiving the Willkie Memo, Applicant worked continuously from 1990-1999 to develop strategies to reduce the invention to practice and to develop strategies to obtain Securities and Exchange Commission (SEC) approval. The financial services, transaction account and investment industries are heavily regulated industries, so numerous government and SEC approvals are typically required to launch any new product. Significantly, it is necessary for any company in these types of industries to wait for SEC approvals before completely reducing the invention to practice because, depending on the

nature of the approval obtained from the SEC, it could have a significant impact on the requirements, functions or processes utilized for reducing the invention to practice.

7. All of the work set forth herein was directly related to the reduction to practice and the work shows the Applicant's reasonable diligence. Numerous meetings and strategy sessions over many years is very common in the industry to reduce any new invention to practice prior to piloting or testing, particularly when the invention is awaiting regulatory developments, or regulatory evaluation and approvals. Applicant sets forth herein evidence of facts establishing due diligence. Applicant also sets forth evidence below that any inactivity or delay during this time is due to the corporate project planning cycle and the need to wait for regulatory changes or approvals. As such, the entire period during which diligence is required is accounted for by either affirmative acts or acceptable excuses.
8. While Applicant had numerous other documents that further provide evidence and support for the statements set forth herein, unfortunately many of those documents were destroyed during the tragic events of September 11, 2001. The AMEX corporate headquarters is located adjacent to the location of the Twin Towers in New York City. While the AMEX headquarters was not directly hit by the hijacked commercial airplanes, the AMEX corporate headquarters received substantial damage from the falling debris and many documents were destroyed. The AMEX employees were not allowed to re-enter their building for many months after the tragedy, while clean-up crews fixed the damage and disposed of numerous important documents and files. Many of the computer systems were also damaged and electronic files were lost.
9. An internal AMEX memo dated June 8, 1994 (Exhibit 2), discloses the significant legal issues and potential resolutions for using an AMEX charge card to buy mutual funds or other securities. This internal memorandum demonstrates continued reduction to practice of the invention because AMEX is continuing its process to obtain the required legal and regulatory approvals in order to determine the requirements, functions or processes that may be required for reducing the invention to practice.

10. In 1994, certain of Applicant's employees completed and submitted the "Compliance & Control Profile" set forth in Exhibit 3. This Profile shows further reduction to practice of the invention because AMEX requires its employees to complete this Profile in order to set up a meeting with the AMEX Business Architect Group responsible for implementing a program to test and commercialize the subject matter of the invention. The form clearly indicates, under the "brief description of the initiative" section, that Applicant's employees were "requesting high level requirements to perform a test with Cardmembers offering Invest on the Card," wherein "clients can purchase mutual funds on their AMEX credit card." This Profile establishes further reduction to practice of the invention because it discloses the request to develop requirements to test the invention.
11. Also in 1994, inventor Mr. Rockell Metcalf drafted an internal memo to AMEX that suggests approaching the SEC for an unprecedented exemption required to reduce the invention to practice. This internal memorandum demonstrates continued reduction to practice of the invention because AMEX is continuing its process to obtain the required SEC approval in order to determine the requirements, functions or processes that the SEC may require for reducing the invention to practice.
12. Also during 1994, AMEX further refined the invention in anticipation of the type of approval likely to be obtained from the SEC. This refinement demonstrates continued reduction to practice of the invention because AMEX is continuing its process to obtain the required SEC approval in order to determine the requirements, functions or processes that the SEC may require for reducing the invention to practice.
13. An internal AMEX memo dated September 11, 1995 (Exhibit 4), again distributes the Willkie Memo set forth in Exhibit A and other information for further discussion on the legal implications of the invention. This memo demonstrates continued reduction to practice of the invention because AMEX is continuing its process to investigate the required SEC and legal approvals in order to determine the requirements, functions or processes that may be required for reducing the invention to practice.



14. An AMEX email dated February 19, 1996 (Exhibit 5) discloses an update on the invention progress and a request to obtain internal approvals. The memo also discloses that AMEX is "aggressively pursuing the two legal options, while at the same time working to design and implement a process to accommodate an April/May test." This email shows further reduction to practice of the invention because it discloses the process steps and decisions that need to be completed before the invention could be implemented.
15. An InterOffice Memo dated February 21, 1996 with "Subject: Securities on the Card Meeting" (Exhibit 6) was sent by AMEX employee Jim Kerkow to various other AMEX employees to inform them of an upcoming meeting regarding the invention. The Memo included as attachments an agenda for a February 27, 1996 "Securities on the Card Design Team Meeting," wherein the meeting Objective is stated as "to develop and recommend an operational view of what a pilot of Securities on the Card should look like." The listed agenda and deliverables for discussion also include developing operational flows, answering questions, gathering data and developing recommendations. This InterOffice Memo shows further reduction to practice of the invention because it discloses the numerous process steps and decisions that need to be completed before the invention could be implemented.
16. An AMEX email dated April 3, 1996 (Exhibit 7) discloses a summary of a conference call to discuss implementation steps and issues related to the invention. This email shows further reduction to practice of the invention because it discloses the process steps and decisions that need to be completed before the invention could be implemented.
17. An AMEX memo dated April 15, 1996 (Exhibit 8) discloses an outline and supporting documentation for the invention background, processes, gating, rules and agenda items. This memo shows further reduction to practice of the invention because it discloses the process steps and decisions that need to be completed before the invention could be implemented.

18. An AMEX memo dated May 1, 1996 (Exhibit 9) discusses various securities issues related to the invention. This memo shows further reduction to practice of the invention because it discloses the process steps and decisions that need to be completed before the invention could be implemented.
19. An AMEX memo dated May 1, 1996 (Exhibit 10) discusses various consumer credit and banking issues related to the invention. This memo shows further reduction to practice of the invention because it discloses the process steps and decisions that need to be completed before the invention could be implemented.
20. An AMEX email dated May 3, 1996 (Exhibit 11) discloses a summary of a meeting to discuss issues, solutions and next steps related to the invention. This email shows further reduction to practice of the invention because it discloses the process steps and decisions that need to be completed before the invention could be implemented.
21. An AMEX email dated May 28, 1996 (Exhibit 12) discloses operational issues related to the invention. This email shows further reduction to practice of the invention because it discloses the process steps and decisions that need to be completed before the invention could be implemented.
22. An AMEX email dated May 28, 1996 (Exhibit 13) discloses possible reward options related to the invention. This email shows further reduction to practice of the invention because it discloses the process steps and decisions that need to be completed before the invention could be implemented.
23. An AMEX email dated May 29, 1996, along with federal regulations (Exhibit 14), discloses amendments to the federal regulations that may impact the implementation of the invention. This email shows further reduction to practice of the invention because it discloses the regulatory requirements which must be contemplated before the invention could be implemented.

24. An AMEX email dated June 17, 1996 (Exhibit 15) discloses status updates for various ideas related to the invention. This email shows further reduction to practice of the invention because it discloses the process steps and decisions that need to be completed before the invention could be implemented.
25. An AMEX email dated June 18, 1996 (Exhibit 16) discloses status updates and next steps for various issues related to the invention. This email shows further reduction to practice of the invention because it discloses the process steps and decisions that need to be completed before the invention could be implemented.
26. An AMEX email dated June 19, 1996 (Exhibit 17) discloses issues related to remittances into the invention. This email shows further reduction to practice of the invention because it discloses the process steps and decisions that need to be completed before the invention could be implemented.
27. A "Project Approach" memorandum (Exhibit 18) was also created in 1996. The Project Approach memorandum outlines anticipated project team roles and responsibilities which are needed as part of AMEX's reduction to practice of the invention.
28. A news release dated February 6, 1997 (Exhibit 19) discloses AMEX management discussion of Directional Robotics potentially working with AMEX to offer stock purchases using a major credit card. This email shows further reduction to practice of the invention because it discloses AMEX's consideration of other companies' products to help with its own process steps and decisions that need to be completed before the invention could be implemented.
29. An AMEX memo dated July 23, 1997 (Exhibit 20) discusses a federal staff opinion regarding the use of credit cards to purchase securities. This internal memorandum demonstrates continued reduction to practice of the invention because AMEX is continuing its process to obtain the required SEC approval in order to determine the requirements, functions or processes that the SEC may require for reducing the invention to practice.

30. A functionality chart entitled "Privileged Assets Functionality – Current RCP Remittances & Settlement Process" (Exhibit 21) was originally created prior to November 17, 1997, as is evidence by the revision date on the bottom of the chart (the chart also includes a fax date of November 25, 1997) . The functionality chart divides various system responsibilities that need to be completed for AMEX to reduce the invention to practice.
31. A powerpoint presentation dated December 15, 1997 (Exhibit 22) provides an overview of the invention's objectives and progress at that time. The presentation also outlines the regulatory constraints and new regulatory developments at the time that "opened the way for AMEX to re-assess the feasibility of offering card billing." The presentation also demonstrates continued reduction to practice of the invention because the presentation outlines solutions to be developed in order "to enable card billing functionality 2Q98."
32. A second powerpoint presentation dated December 15, 1997 and entitled "Investing on the Card – Assessment Update" (Exhibit 23) provides an overview of a feasibility assessment of the invention. The presentation also demonstrates continued reduction to practice of the invention because it discloses the business issues and decisions that need to be considered before the invention could be implemented.
33. In 1997, senior AMEX management authorized approaching the SEC to seek approval from the SEC for reducing the invention to practice, so inventor Rockell Metcalf called the SEC to inquire about approval. This process demonstrates continued reduction to practice of the invention because AMEX is continuing its process to obtain the required SEC approval in order to determine the requirements, functions or processes that the SEC may require for reducing the invention to practice.
34. Also in 1997, AMEX later received a Notice stating that implementation of the invention would violate the SEC Broker Dealer Registration Securities Laws. AMEX was obligated to comply with this Notice of violation. Without the requisite SEC approval, AMEX was prevented from undertaking any major steps toward implementation or reduction to practice of the invention.

35. In response to the Notice of violation, AMEX then prepared and filed a request for an exemption of the applicable SEC Law based upon public policy considerations. This SEC request demonstrates continued reduction to practice of the invention because AMEX is continuing its process to obtain the required SEC approval in order to determine the requirements, functions or processes that the SEC may require for reducing the invention to practice.
36. Billing Data Flow and Account Setup Data Flow documents (Exhibit 24) were created on or before March 11, 1998 (the documents indicate a facsimile stamp of March 11, 1998). These Data Flow documents demonstrate continued reduction to practice of the invention because the documents disclose the proposed functions of different systems and the proposed data flowing through those systems as part of AMEX's reduction to practice of the invention.
37. A letter dated April 21, 1998 from AMEX to its outside counsel (Exhibit 25) outlines AMEX's efforts to design the invention and AMEX requests outside counsel input on certain issues related to the invention. This letter and outline of issues demonstrate continued reduction to practice of the invention because AMEX is continuing its process to obtain the required SEC approval in order to determine the requirements, functions or processes that the SEC may require for reducing the invention to practice.
38. Inventor Rockell Metcalf received an internal AMEX Memorandum dated May 11, 1998 from Brian Kleinberg (Exhibit 26) setting forth the agreed upon strategy for obtaining the required SEC approval and setting forth details regarding AMEX's proposed reduction to practice of the invention. This AMEX Memorandum demonstrates continued reduction to practice of the invention because AMEX is continuing its process to obtain the required SEC approval in order to determine the requirements, functions or processes that the SEC may require for reducing the invention to practice.
39. Inventor Rockell Metcalf was copied on an internal AMEX memorandum dated June 10, 1998 (Exhibit 27) confirming that AMEX is still in the process of obtaining SEC approval

and outlining the allocation of responsibility for the risks associated with the invention. This AMEX Memorandum includes a ten (10) page attachment which is a proposed letter from AMEX to the SEC. The proposed letter outlines the intended process of the invention and the regulatory issues raised by the intended process in an effort to obtain a non-enforcement decision from the SEC. This AMEX memorandum and the attached letter demonstrates continued reduction to practice of the invention because AMEX is continuing its process to obtain the required SEC approval in order to determine the requirements, functions or processes that the SEC may require for reducing the invention to practice.

40. An AMEX document entitled "Investing On the Card Market Test" dated June 22, 1998 (Exhibit 28, which includes the cover page only because the remaining portion of the document is considered confidential) discloses various details related to the invention, along with its proposed design, cost estimates, controls and other business items. This AMEX document demonstrates continued reduction to practice of the invention because AMEX is continuing its testing process as part of reducing the invention to practice.
41. Inventor Rockell Metcalf was copied on an internal email dated July 1, 1998 (Exhibit 29) discussing whether or not to include mutual funds as an investment item in the invention. This AMEX email demonstrates continued reduction to practice of the invention because AMEX is continuing its process to obtain the required SEC approval in order to determine the requirements, functions or processes that the SEC may require for reducing the invention to practice and AMEX's ongoing efforts to analyze certain issues related to reducing the invention to practice.
42. AMEX sent a letter dated September 8, 1998 (Exhibit 30) to the SEC to obtain assurances that the SEC would not recommend an enforcement action against AMEX if AMEX implemented and operated the invention for its cardmembers. The letter outlines the proposed system and provides a detailed analysis of the related regulatory issues. This letter demonstrates continued reduction to practice of the invention because AMEX is continuing its process to obtain the required SEC approval in order to determine the

requirements, functions or processes that the SEC may require for reducing the invention to practice.

43. Inventor Rockell Metcalf received an internal memorandum dated September 11, 1998 (Exhibit 31) regarding a revised strategy for working with the SEC and obtaining the required SEC approval. This memorandum demonstrates continued reduction to practice of the invention because AMEX is continuing its process to obtain the required SEC approval in order to determine the requirements, functions or processes that the SEC may require for reducing the invention to practice.
44. Inventor Rockell Metcalf sent a letter, via facsimile, dated October 1, 1998 to the SEC (Exhibit 32) explaining the existing AMEX requirements for the invention, along with a promise to submit a summary of the overall federal and state regulatory regime which would govern AMEX's implementation of the invention. This letter demonstrates continued reduction to practice of the invention because AMEX is continuing its process to obtain the required SEC approval in order to determine the requirements, functions or processes that the SEC may require for reducing the invention to practice.
45. On October 27, 1998, AMEX sent a facsimile letter (Exhibit 33) to its outside counsel (Snell & Wilmer, L.L.P), along with the letter set forth in Exhibit L, informing them that additional disclosure information will be provided. The letter requested that they analyze the proposed invention to determine a strategy for obtaining intellectual property protection for the invention. The letter also indicates that the AMEX General Counsel's Office sent the appropriate forms to the AMEX employees working on the invention in order to initiate the patent application process in accordance with the then-current AMEX intellectual property policy.
46. On November 3, 1998, AMEX's representatives, including inventor Rockell Metcalf, met with the SEC, as evidenced by the meeting agenda and the various accompanying documents set forth in Exhibit 34, to discuss the issues related to the requested approval in order to implement the invention. The agenda and documents demonstrate continued

reduction to practice of the invention because AMEX is continuing its process to obtain the required SEC approval in order to determine the requirements, functions or processes that the SEC may require for reducing the invention to practice.

47. Also on November 3, 1998, an AMEX email (Exhibit 35) was distributed internally to update AMEX officers on the progress of the discussions with the SEC and inform them that additional information may need to be supplied to the SEC and that the AMEX proposal to the SEC may need to be restructured. This email demonstrates continued reduction to practice of the invention because AMEX is continuing its process to obtain the required SEC approval in order to determine the requirements, functions or processes that the SEC may require for reducing the invention to practice.
48. On November 5, 1998, inventors Rockell Metcalf and Suzanne Crane received an internal AMEX email, along with an attachment (Exhibit 36), discussing the design and content for revising billing statements in conformance with the invention. This AMEX email demonstrates continued reduction to practice of the invention because AMEX continued to develop certain aspects of the invention, namely, revised billing statements that disclose contributions into a brokerage account.
49. The email thread set forth in Exhibit 37 shows that on November 6, 1998, Snell & Wilmer attorney Howard Sobelman sent an email to AMEX recommending that a clearance search be conducted to determine if the invention is patentable. After obtaining the appropriate approvals, AMEX sent an email to Howard Sobelman on November 10, 2004 authorizing the recommended clearance search. Howard Sobelman then sent a letter dated November 11, 1998 (Exhibit 38) to Washington Patent Services Corp. instructing them to conduct the referenced search. Washington Patent Services Corp. sent a letter dated November 17, 1998 to Howard Sobelman enclosing the results of the search (Exhibit 39). On December 8, 1998, after analyzing the numerous patents disclosed in the search, Howard Sobelman reported the results to AMEX (Exhibit 40, which includes only the first page which is redacted because the document is considered confidential) and recommended pursuing a patent application for the invention. This process demonstrates continued reduction to



practice of the invention because it is the required AMEX process for pursuing patent protection.

50. Upon receipt of the recommendation from Howard Sobelman, in accordance with the then-current AMEX intellectual property policy, a New Invention Disclosure Form and Patent Checklist was completed, which, along with other disclosure documents, were sent to Howard Sobelman on January 6, 1999, (Exhibit 41). During the course of preparing the patent application, Howard Sobelman requested additional information and clarification on certain functions during various conference calls. This process demonstrates continued reduction to practice of the invention because it is the required AMEX process for pursuing patent protection.
51. AMEX sent a letter dated January 11, 1999 to J&H Marsh and McLennan (Exhibit 42) regarding surety, bond and regulatory issues related to reducing the invention to practice. This AMEX letter demonstrates continued reduction to practice of the invention because AMEX is continuing to address issues related to surety, bonds and regulations as part of its reduction to practice of the invention.
52. AMEX first published its Project Definition Report (Exhibit 43, which includes only the memo, cover page and table of contents because the remaining pages are considered confidential) for the invention on February 16, 1999. The Project Definition Report was subsequently revised on March 4, 1999. AMEX requested internal approvals on the final draft of the Report on March 15, 1999. This Report outlines extensive details for reducing the invention to practice. This Report demonstrates continued reduction to practice of the invention because AMEX is further developing the detailed requirements for reducing the invention to practice.
53. On April 16, 1999, inventor Suzanne Crane sent Howard Sobelman, via facsimile, additional disclosure documents (Exhibit 44) to supplement the draft patent application. Howard Sobelman sent an email dated April 21, 1999 (Exhibit 45) requesting further clarification from inventor Suzanne Crane and Suzanne Crane responded with answers in

various emails dated April 28, 1999 (Exhibit 46). In attachment to an email dated April 28, 1999 (Exhibit 47), Suzanne Crane also provided Howard Sobelman with a copy of the Project Definition Report set forth in Exhibit 43. This process demonstrates continued reduction to practice of the invention because it is the required AMEX process for pursuing patent protection.

54. Howard Sobelman sent a revised draft of the patent application (Exhibit 48) to Suzanne Crane on April 30, 1999 requesting that all inventors review the patent application. Suzanne Crane sent her comments on the draft patent application to Rockell Metcalf, via facsimile, on May 27, 1999 (Exhibit 49). Over the next few months, each AMEX inventor provided input to Howard Sobelman, along with various updated drawings, flowcharts and technical clarifications. Howard Sobelman sent an email dated October 5, 1999 to Suzanne Crane and Rockell Metcalf, along with a copy of a further revised draft of the patent application, requesting their review (Exhibit 50). In various emails dated October 8, 1999 and October 11, 2005 (Exhibit 51), the inventors provided additional comments and revisions to Howard Sobelman. Once the inventors provided their approval of the patent application, Howard Sobelman finalized the patent application, and prepared the associated declarations and assignments for filing with the United States Patent and Trademark Office. This process demonstrates continued reduction to practice of the invention because it is the required AMEX process for pursuing patent protection for this invention.
55. As set forth in the email dated October 12, 1999 from Rockell Metcalf to Howard Sobelman (Exhibit 52), in accordance with AMEX policy, it was necessary to obtain approval from the Transaction Card lawyer prior to filing the patent application. This process demonstrates continued reduction to practice of the invention because it is the required AMEX process for pursuing patent protection for this invention.
56. Snell & Wilmer filed the patent application covering the invention on October 12, 1999.

57. We do not know, and do not believe, that this invention has been in public use or on sale in this country, or patented or described in a printed publication, in this or in a foreign country, for more than one year prior to the filing of our patent application.
58. We hereby declare that all statements made herein of my own knowledge are true and that all statements made on information and belief are believed to be true; and further that these statements were made with the knowledge that willful false statements and the like so made are punishable by fine or imprisonment, or both, under Section 1001 of Title 18 of the United States Code, and that such willful false statements may jeopardize the validity of the above-referenced application or any patent issuing thereon.

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Full name of fifth joint inventor: Joan Prairie  
Inventor's signature: \_\_\_\_\_ Date: \_\_\_\_\_  
City/State/Country of Residence: Minneapolis, MN, USA  
Mailing Address: 2715 West 28<sup>th</sup> Street  
City/State: Minneapolis, MN Zip Code: 55416 Country: USA  
Citizenship: United States of America

Full name of sixth joint inventor: Rockell Metcalf  
Inventor's signature: \_\_\_\_\_ Date: \_\_\_\_\_  
City/State/Country of Residence: New York, NY, USA  
Mailing Address: 40 Wall Street - 19<sup>th</sup> Floor, Mail Code: 10-19-07  
City/State: New York, NY Zip Code: 10005 Country: USA  
Citizenship: United States of America

Full name of first joint inventor: Suzanne P. Crane  
Inventor's signature: \_\_\_\_\_ Date: \_\_\_\_\_  
City/State/Country of Residence: New Hope, MN, USA  
Mailing Address: 5249 Pennsylvania  
City/State: New Hope, MN Zip Code: 55428 Country: USA  
Citizenship: United States of America

Full name of second joint inventor: Marcus Sheire  
Inventor's signature: \_\_\_\_\_ Date: \_\_\_\_\_  
City/State/Country of Residence: St. Paul, MN, USA  
Mailing Address: 1540 Osceola Avenue  
City/State: St. Paul, MN Zip Code: 55105 Country: USA  
Citizenship: United States of America

Full name of third joint inventor: Mark D. Swcazy  
Inventor's signature: \_\_\_\_\_ Date: \_\_\_\_\_  
City/State/Country of Residence: Minnetonka, MN, USA  
Mailing Address: 15201 Crown Drive  
City/State: Minnetonka, MN Zip Code: 55345 Country: USA  
Citizenship: United States of America

Full name of fourth joint inventor: Bonnie Hein  
Inventor's signature: \_\_\_\_\_ Date: \_\_\_\_\_  
City/State/Country of Residence: Brooklyn Park, MN, USA  
Mailing Address: 9951 Chestnut Avenue N  
City/State: Brooklyn Park, MN Zip Code: 55443 Country: USA  
Citizenship: United States of America

Full name of fifth joint inventor: Joan Prairie  
Inventor's signature: Joan Prairie Date: 02/06/2006  
City/State/Country of Residence: Minneapolis, MN, USA  
Mailing Address: 2715 West 28<sup>th</sup> Street  
City/State: Minneapolis, MN Zip Code: 55416 Country: USA  
Citizenship: United States of America

Full name of sixth joint inventor: Rockell Metcalf  
Inventor's signature: \_\_\_\_\_ Date: \_\_\_\_\_  
City/State/Country of Residence: New York, NY, USA  
Mailing Address: 40 Wall Street - 19<sup>th</sup> Floor, Mail Code: 10-19-07  
City/State: New York, NY Zip Code: 10005 Country: USA  
Citizenship: United States of America



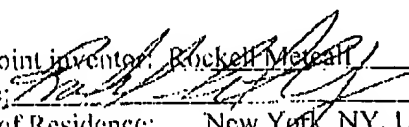
Full name of first joint inventor: Suzanne P. Crane  
Inventor's signature: \_\_\_\_\_ Date: \_\_\_\_\_  
City/State/Country of Residence: New Hope, MN, USA  
Mailing Address: 5249 Pennsylvania  
City/State: New Hope, MN Zip Code: 55428 Country: USA  
Citizenship: United States of America

Full name of second joint inventor: Marcus Sheire  
Inventor's signature: \_\_\_\_\_ Date: \_\_\_\_\_  
City/State/Country of Residence: St. Paul, MN, USA  
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Citizenship: United States of America

Full name of third joint inventor: Mark D. Sweazy  
Inventor's signature: \_\_\_\_\_ Date: \_\_\_\_\_  
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Mailing Address: 15201 Crown Drive  
City/State: Minnetonka, MN Zip Code: 55345 Country: USA  
Citizenship: United States of America

Full name of fourth joint inventor: Bonnie Hein  
Inventor's signature: \_\_\_\_\_ Date: \_\_\_\_\_  
City/State/Country of Residence: Brooklyn Park, MN, USA  
Mailing Address: 9951 Chestnut Avenue N  
City/State: Brooklyn Park, MN Zip Code: 55443 Country: USA  
Citizenship: United States of America

Full name of fifth joint inventor: Joan Prairie  
Inventor's signature: \_\_\_\_\_ Date: \_\_\_\_\_  
City/State/Country of Residence: Minneapolis, MN, USA  
Mailing Address: 2715 West 28<sup>th</sup> Street  
City/State: Minneapolis, MN Zip Code: 55416 Country: USA  
Citizenship: United States of America

Full name of sixth joint inventor: Rockett Mercall  
Inventor's signature:  Date: Jan. 25 2006  
City/State/Country of Residence: New York, NY, USA  
Mailing Address: 40 Wall Street - 19<sup>th</sup> Floor, Mail Code: 10-19-07  
City/State: New York, NY Zip Code: 10005 Country: USA  
Citizenship: United States of America

# **EXHIBIT 1**

WILLKIE FARR & GALLAGHER

WB-34

MEMORANDUM

TO: American Express Travel Related Services Company, Inc.  
RE: The American Express Funds: Asset Builder Program  
DATED: September 14, 1990

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SUMMARY

This Memorandum addresses legal issues arising under the federal securities laws in connection with offering American Express Cardmembers ("Cardmembers") the opportunity to invest in The American Express Funds (the "Company") through payments of their American Express Card bills. (For ease of reference, this program is referred to in this Memorandum as the "Asset Builder Program" or the "Program.") Implementation of the Program raises a number of legal issues under the federal securities laws.<sup>1</sup> In general, however, we believe that these laws should not impose substantial restraints on the Program, except in two areas: (1) the collection of moneys by American Express Travel Related Services Company, Inc. ("TRS"), an entity that is not registered as a broker-dealer under federal securities laws, and (2) the investment by TRS of its own assets on a fixed date on behalf of a Cardmember in advance of receipt of payments by the Cardmember. Complex issues are raised concerning the collection of moneys under the Program.

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<sup>1</sup> While it is beyond the scope of this Memorandum to survey applicable law in all states in which the Program might become available, we have included general references to possible concerns arising under state securities laws.

Although several resolutions to these issues present themselves, each of them involves disadvantages from legal and business perspectives. In addition, neither TRS nor AESC could invest its own assets on behalf of Cardmembers in advance of receipt of payments by Cardmembers without violating applicable credit regulations. Nevertheless, with certain modifications -- which are suggested herein -- we are of the view that the Program could be established in conformance with the federal securities laws. In view of the novelty of the Program, however, we recommend meeting with the National Association of Securities Dealers, Inc. and perhaps with the staff of the Securities and Exchange Commission and representatives of certain state securities commissions, as well.

#### BACKGROUND INFORMATION

##### The Company

The Company, an open-end management investment company organized as a Massachusetts business trust, is a series company that offers investors a selection of nine investment funds (the "Funds"). Shares of the Funds are offered by American Express Service Corporation ("AESC"), a wholly-owned subsidiary of TRS. AESC is registered with the Securities and Exchange Commission (the "Commission") as a broker-dealer and an investment adviser. AESC is also registered with all states that require registration of broker-dealers and investment advisers. Two Funds (the "Fixed NAV Funds") are no-load money

market funds that seek to maintain a constant net asset value of \$1.00 consistent with Rule 2a-7 under the Investment Company Act of 1940, as amended (the "1940 Act"). The value of shares of the remaining seven load Funds (the "Fluctuating NAV Funds") fluctuates in relation to the value of their portfolio assets.

#### The Asset Builder Program

We understand that the Asset Builder Program is proposed to operate as follows:

- o A Cardmember would notify AESC of the amount the Cardmember intends to invest in the Company on a monthly basis (the "Intended Investment Amount"). Presumably, Cardmembers would also designate the Fund or Funds into which investments made under the Program would be invested. A Cardmember must enroll or re-enroll in the Program in writing; the Intended Investment Amount and, we assume, the Fund or Funds designated for investment could be changed, and participation in the Asset Builder Program could be terminated, by telephone.
- o The Intended Investment Amount would be reflected on the monthly American Express Card billing statement (the "Monthly Statement") as an amount due or as a reminder to remit such amount.
- o A Cardmember would send a single check in payment of his or her American Express Card bill along with an amount not exceeding the Intended Investment Amount to TRS to be received at a TRS operations or processing center in one of seven states.
- o A Cardmember may also make payment of his American Express Card bill and an amount not exceeding the Intended Investment Amount at a local TRS Travel Service office.
- o Amounts received by TRS for investment in the Company would be forwarded by TRS to The Shareholder Services Group, Inc. ("TSSG"), the Company's transfer agent, for investment in the Funds previously designated by Cardmembers.

Amounts would be forwarded as promptly as possible, but it may take three to four days to process payments received.

- Both the Fixed NAV Funds and the Fluctuating NAV Funds would be available for investment under the Asset Builder Program.
- Descriptions of the Asset Builder Program could be contained in general advertising and solicitation materials describing the American Express Card produced and distributed by TRS (e.g., American Express Card benefit books, direct mail solicitations, American Express Card applications, television advertisements).
- Each Cardmember would be provided with a copy of the relevant Fund's prospectus before or at the time he enrolls in the Asset Builder Program, which prospectus will contain appropriate disclosure concerning the Program.

We understand that there are three alternative methods under consideration for investing Intended Investment Amounts in the Company, as follows:

Alternative No. 1 -- Fixed Date Investment. Under this alternative, TRS would invest the Intended Investment Amount from its own assets in the appropriate Fund or Funds in the name of the Cardmember on a fixed date after the American Express Card bill had been sent to the Cardmember. Although a Cardmember would pay his bill after such fixed date, the investment would be deemed to have been made by the Cardmember on the date the investment was made by TRS. If a Cardmember failed to invest all or some part of the Intended Investment Amount within the time permitted/for payment of his American Express bill, shares of the Company purchased on his behalf would be sold in an amount sufficient to reimburse TRS for the difference between the

Intended Investment Amount and the amount, if any, paid by the Cardmember. The redemption proceeds would be remitted to TRS. Failure to pay the full Intended Investment Amount a certain number of times would result in termination of the Asset Builder Program with respect to the Cardmember.

Alternative No. 2 -- Overpayment Investment. Under this alternative, the amount received that exceeded the amount of regular American Express Card bill charges would be separately identified and transferred to TSSG for investment in the Company on behalf of the Cardmember. Such amount, not to exceed the Intended Investment Amount, would be invested at the time received from the Cardmember.

Alternative No. 3 -- Sweep Investment. Under this alternative, any credit balance created by a Card transaction up to the Cardmember's Intended Investment Amount would be automatically transferred to TSSG for investment in the Company on behalf of the Cardmember.

#### DISCUSSION

Implementation of the Asset Builder Program under one or more of the three alternatives described above raises a number of issues under federal securities laws, involving advertising, the collection of moneys, extension of credit (margin) and the pricing of share purchases. We discuss below each of these areas in turn, after which certain miscellaneous matters are addressed. Finally, in the Appendix to this Memorandum we provide guidance

with respect to specific questions and issues raised in a letter dated August 16, 1990 from Timothy J. Heine, Esq. to Burton M. Leibert, Esq.

Advertising

Two legal issues are raised by the proposed methods of advertising the Asset Builder Program as described above: (1) the limitations on including an advertisement for the Asset Builder Program in materials describing the Card and (2) the extent to which TRS, rather than AESC, can be featured in sales material and advertisements describing the Asset Builder Program. In general, we believe that neither issue should impose substantial restraints on the proposed Program.

Joint Card/Program Advertising. The staff of the Commission has recently articulated guidelines for the preparation of newsletters and similar periodic publications by investment companies.<sup>2</sup> The ICI Letter specifically addresses the permissibility of incorporating material governed by Rules 134, 135a and 482 under the Securities Act of 1933, as amended (the "1933 Act"), with material that would not fall within the scope of such Rules ("non-Rule material"). A discussion of the various advertising rules applicable to investment companies is beyond the scope of this Memorandum. Under those rules, however, an advertisement describing the Program could be crafted to come within the itemized information permitted under Rule 134 and,

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<sup>2</sup> See Investment Company Institute, SEC No-Action Letter (January 19, 1990) (the "ICI Letter").



since the Company's Prospectus and Statement of Additional Information presumably would be amended to describe the operation of the Asset Builder Program, advertising describing the Program could also satisfy the requirements of Rule 482.<sup>3</sup> The ICI Letter states that non-Rule material may be included in a newsletter<sup>4</sup> containing information permitted under Rule 134 and/or Rule 482 if it does not constitute an "offer" of a security under the 1933 Act. Information not constituting an offer would be considered "free writing" material that could be included together with a description of the Asset Builder Program, provided it is segregated from that material.

Whether material is permissible "free writing" or an impermissible "offer" depends on what it says. Generally, according to the ICI Letter, newsletter material would probably constitute an offer if it directly or indirectly promoted or encouraged a decision by the reader to make an investment in a particular fund or funds offered or about to be offered by the sponsor. Each advertisement describing the Asset Builder Program must be analyzed individually against this standard. In

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<sup>3</sup> Both Rule 482 and Rule 134 require that legends be placed on advertisements stating from whom a prospectus containing more complete information about the Company, including expenses and charges, may be obtained and that an investor should read the prospectus carefully before investing. Such legends will need to be placed on all joint Card/Program advertising.

<sup>4</sup> The ICI Letter by its terms relates only to newsletters and "similar periodic publications." Nevertheless, the guidelines set forth in the letter should be equally applicable to individual advertisements.

developing the format and scope for such advertising, you should be prepared to separate references to the Program from "free writing" relating to the American Express Card and other services available through TRS and the Card.

Use of TRS Name in Advertisements. Article III, Section 35 of the Rules of Fair Practice of the National Association of Securities Dealers, Inc. ("NASD") sets forth basic standards governing communications by NASD members with the public. Section 35(d)(2)(A) provides that each advertisement and piece of sales literature must contain the name of the NASD member; each piece of sales literature also must contain the date on which the material was first published.<sup>5</sup> The NASD has stated publicly

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<sup>5</sup> The NASD distinguishes between "advertisements" and "sales literature", as follows:

(1) Advertisement -- material published, or designed for use in, a newspaper, magazine or other periodical, radio, television, telephone or tape recording, videotape display, signs or billboards, motion pictures, telephone directories (other than routine listings), or other public media.

(2) Sales Literature -- any written communication distributed or made generally available to customers or the public, which communication does not meet the foregoing definition of "advertisement". Sales literature includes, but is not limited to, circulars, research reports, market letters, performance reports or summaries, form letters, standard forms of options worksheets, seminar texts, and reprints or excerpts of any other advertisement, sales literature or published article.

NASD, Rules of Fair Practice, Article III, §35(a).

that the name of an entity other than the NASD member can be shown in an advertisement so long as the name of the member is also shown in a relatively prominent manner. In general, state securities laws permit the use of advertising or sales literature that complies with Commission and NASD rules. Thus, an advertisement or piece of sales literature can focus on TRS or American Express Company as offering the Program, as long as AESC's name is also mentioned or displayed with some prominence.

#### Collection of Moneys

The sending of a single check in payment of both regular charges on a Cardmember's American Express Card bill and amounts paid under the Asset Builder Program should not raise any regulatory concern. However, the collection of moneys under the Asset Builder Program by TRS -- as opposed to AESC, a registered broker-dealer -- does.

In several instances, all of which involved insurance companies, the staff of the Commission has explicitly permitted a single check sent to an insurance company to be used in payment of the purchase price of mutual fund shares and life insurance premiums.<sup>6</sup> In contrast, however, the staff of the Commission has stated on more than one occasion that an agent that receives funds from mutual fund customers would generally be required to register as a broker-dealer under the Securities Exchange Act of

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Boston Mutual Sales Corp., SEC No-Action Letter (January 4, 1973); Investors Insurance Corporation, SEC No-Action Letter (May 10, 1971).

1934 (the "1934 Act"). In one instance the staff stated that dealers or investors could forward orders for fund shares directly to a service agent that would process the orders and send confirmations of transactions to investors for a fee, but suggested that the service agent as a result of providing these services would generally be required to register as a broker-dealer.<sup>7</sup> In another, an insurance company at no charge was permitted to receive amounts to be invested in fund shares and then to remit such amounts to a general agent that was a registered broker-dealer, the staff again suggesting that the insurance company's activities would require it to register as a broker-dealer.<sup>8</sup>

Of course, it would be possible to discuss the matter of TRS's collection of moneys under the Asset Builder Program directly with the staff of the Commission. Recognizing that the no-action letters referred to above were more than fifteen years old, we informally discussed with a member of the Commission's staff the staff's continued adherence to the view that a party receiving orders for fund shares must be registered as a broker-dealer. The staff member stated that, in his view, the staff should be willing to allow a service agent to act as a collection agent in connection with purchases of fund shares

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Investment Company Institute, SEC No-Action Letter (June 13, 1973).

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State Security Life Insurance Company, SEC No-Action Letter (June 7, 1971); see also Investors Insurance Corporation, SEC No-Action Letter (May 10, 1971).

*we could convince*

without becoming a registered broker-dealer if the agent was supervised by a registered broker-dealer that was responsible for the acts of the agent and if no fee were paid directly by customers to the service agent.<sup>9</sup> Thus, if AESC would agree to supervise the activities of TRS and assume responsibility for losses arising from its activities (which may necessitate substantial increases in AESC's capital), it may be possible to <sup>propose or</sup> convince the staff that there is no real need for direct regulatory control over TRS, which would merely be acting as AESC's collection agent. However, the NASD, as well as the SEC, may very well continue to be concerned about undifferentiated moneys being paid to an unregulated entity. We expect that they would insist, at a minimum, that TRS employees handling money for AESC be treated also as employees of AESC and be subject to AESC's direct supervision and control. In addition, it should be recognized that even if the staff of the Commission were to confirm that TRS may collect money without registration as a

*no acting orders*

9 Under Part III of Schedule C to the By-Laws of the NASD, persons associated with NASD members who accept unsolicited customer orders for submission to the member for execution ("Assistant Representatives--Order Processing") must register with the NASD and pass a qualifying examination. Persons associated with a member whose functions are "solely and exclusively clerical or ministerial" are, however, exempt from registration. NASD By-Laws, Schedule C, Part VI § 1(a). Presumably, a person who merely opens envelopes containing moneys in payment for Company shares and American Express Card bill payments, who neither writes order tickets nor communicates with investors, would be considered to be acting in a clerical capacity

broker-dealer, one or more state securities commissions may take a contrary position.

Absent relief from the Commission, it appears that TRS would be required to register as a broker-dealer in each jurisdiction in which it would receive moneys under the Program. As you know, broker-dealer registration involves time, expense and, perhaps more importantly, subjecting TRS's operations to a new regulatory regime. We have considered ways in which the Program could be modified so that moneys are collected by AESC, which would obviate the need for registration by TRS. One or more of these payment alternatives may be unacceptable from a business point of view. Nevertheless, we set them out here for your consideration:

1. Parallel AESC/TRS Offices. An AESC office could be created at each TRS operations center that receives payments on Card bills. Checks could be made payable to "American Express" and mailed to such operations centers. The return envelope or the portion of the American Express Card bill enclosed with the payment could be coded so that only payments from Cardmembers participating in the Asset Builder Program would be directed to the AESC office at the TRS operations center. AESC would then credit back to TRS the amount paid in respect of regular American Express Card charges.
2. Direct Payments to Existing AESC Office. Alternatively, a single check for the aggregate of the Intended Investment Amount and the amount otherwise to be paid on an American Express Card bill could be made payable to and forwarded directly to AESC, which would then credit back the difference between the Intended Investment Amount and the total paid to TRS.
3. Separate Program Checks. As a third alternative, a separate check for the Intended Investment

Amount could be issued to the Company or, if AESC is the payee, it could be sent to a bank (such as Centurion Bank) or to AESC. To facilitate this, a separate envelope addressed to the Fund or to AESC could be enclosed with the Monthly Statement.

Each of the above presents different regulatory and/or business concerns. We think that the most useful approach may be the first one, although the third alternative is cleanest from a regulatory standpoint. The first alternative, by having only payments by those Cardmembers participating in the Program directed to AESC, reduces the logistical and other problems of the second alternative, which contemplates having AESC, a thinly-capitalized broker-dealer, assume control over what we assume are billions of dollars of Cardmembers' bill payments merely for the purpose of collecting what may well be a very small portion of that amount. The net capital requirements applicable to AESC will increase substantially as a result of AESC's receipt of the aggregate bill and Program payments of all Cardmembers, whether participating in the Program or not. AESC's net capital would be affected to a lesser extent if only aggregate payments from Program participants were directed to it, and it would be unaffected if a separate check for amounts paid under the Program were made out to the Company, as is contemplated as part of the third alternative. (We would be pleased to discuss with you the specific net capital implications for AESC of receiving bill payments, or you may wish to raise this issue with your accountants.) The first

alternative also avoids the use of two checks, which the third alternative contemplates and which may discourage investing and run counter to the philosophy underlying the Program. It should be noted, however, that the cost of substantially increasing AESC's capital may nonetheless warrant following the separate check approach in Alternative No. 3.

The first alternative would require the creation of additional AESC offices throughout the country. In the absence of a contrary interpretation from the NASD, each office would be required to have a registered principal on site. We are cautiously optimistic that the NASD could be persuaded that this would not be necessary since (1) the AESC employee's activities would be limited to opening envelopes, (2) no sales of securities would occur at the site and (3) no person would be dealing with the public or commenting on whether Company shares represent a suitable investment. In discussions with the NASD on this matter, it would probably be helpful to have amended AESC's compliance manual to provide for the collection of moneys at the new locations and the forwarding of such amounts to TSSG and to undertake to perform a quarterly internal audit of compliance with those procedures. Given the large number of TRS Travel Service offices, opening an AESC office in each such location would no doubt prove unworkable. This may necessitate a decision not to accept Intended Investment Amounts at TRS Travel Service offices and to require



that they be sent by mail by the Cardmember-investor to a TRS operations center.

#### Extension of Credit

Alternative No. 1, described above as the "Fixed Date Investment", involves the investment by TRS of its own assets on behalf of Cardmembers in advance of receipt of payments by Cardmembers. This payment alternative raises an issue under Regulation G, promulgated by the Board of Governors of the Federal Reserve System, if TRS advances amounts to Cardmembers for the purchase of Company shares and under Section 11(d)(1) of the 1934 Act and the Federal Reserve Board's Regulation T.

Regulation G applies to persons other than banks, brokers or dealers who extend or maintain credit secured directly or indirectly by margin stock. It limits the loan value of the collateral securing the credit if the purpose of the credit is to buy, trade in or carry margin stock ("purpose credit").<sup>10</sup> "Margin stock" includes any security issued by a registered investment company (with certain limited exceptions not relevant here).<sup>11</sup> Generally, no Regulation G lender may extend purpose credit in an amount that exceeds 50% of the current value of the margin stock involved if the loan is secured, directly or indirectly, by any margin security. Alternative No. 1 would likely violate Regulation G because it involves TRS's extending credit equal to 100% of the value of

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<sup>10</sup> 12 C.F.R. § 207.1(b) (1989).

<sup>11</sup> 12 C.F.R. § 207.2(i)(6) (1989).

the Company shares to be acquired and would likely be deemed to involve a loan indirectly secured by the Company shares being purchased.<sup>12</sup>

If TRS were deemed to be acting as the agent of AESC or if AESC were itself to purchase Company shares in advance of the receipt of Intended Investment Amounts from Cardmembers or, as is likely the case, AESC were deemed to have "arranged" the extension of margin credit by TRS, AESC would violate Section 11(d)(1) of the 1934 Act and Regulation T. Section 11(d)(1) prohibits a broker-dealer from extending or arranging for the extension of credit to or for a customer on any security (other than certain exempted securities) that was part of a new issue in which the broker-dealer participated as a member of a selling syndicate or group within 30 days prior to the transaction. Rule 11d1-2 excepts from the prohibition of Section 11(d)(1) an extension of credit for the purchase of mutual fund shares to a person who has held such shares for

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<sup>12</sup> Were the Program to be structured such that in the event of non-payment of the Intended Investment Amount by the Cardmember after TRS or AESC had acquired shares on his or her behalf, neither TRS nor AESC, as the case may be, would have the right to redeem Company shares, or impose a lien against or restrict in any way the Cardmember's withdrawal of the shares before his or her full payment for them, it may be argued that the credit extended was not secured directly or indirectly by shares of the Company. In this event, TRS or AESC, as the case may be, would be placed in the posture of having made an unsecured loan to the Cardmember who fails to pay the Intended Investment Amount. Asserting rights against a defaulting Cardmember may be difficult and, in any event, would involve delay and perhaps expense out of proportion to the amount in default.

more than 30 days. Since under Alternative No. 1 the full purchase price would be advanced at the time of the customer's purchase and at a time when AESC was the principal underwriter of the Company's shares, the exception provided by Rule 11d1-2 would not apply and the prohibition contained in Section 11(d)(1) would bar AESC from advancing the purchase price of Company shares to Cardmembers, or arranging for any such advance.<sup>13</sup> If an entity other than AESC were to advance the funds, it is nevertheless likely that AESC would be deemed to have "arranged" the credit, which would also involve a Regulation T violation.

Regulation T governs the extension and arrangement of credit by brokers and dealers and imposes, among other things, initial margin requirements and payment rules on securities transactions. Under Regulation T a broker or dealer may not extend purpose credit otherwise than in a margin account and may not extend credit in a margin account that exceeds 50% of the current market value of a margin security. As under Regulation G, the term "margin security" includes shares issued by registered open-end investment companies. Again, Alternative No. 1 would violate Regulation T since it

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<sup>13</sup> Section 11(d)(1) and Rule 11d1-2 thereunder would present no obstacle if the extension of credit were secured only by Company shares held for more than 30 days and the credit extended did not exceed 50% of the value of those shares. Implementing this approach, however, would seem to present operational difficulties.

contemplates AESC's advancing, or arranging to have advanced, 100% of the value of the Company shares purchased.

Alternative No. 1 also exposes the entity extending credit to purchase Fluctuating NAV Fund shares to the risk of a failure by a Cardmember to pay the Intended Investment Amount for such shares. In this event, TRS or AESC, as the case may be, would liquidate the Fund shares acquired, but would incur a loss to the extent that the value of the Fund shares on the date of purchase exceeded their value on the day redeemed. It has been the long-standing position of the staff of the Commission that where investors fail to make payment for shares ordered and the purchase order is, as a result, reversed, any loss should be borne by the principal underwriter of the fund involved, rather than by the fund itself.<sup>14</sup> In such an instance, AESC as the principal underwriter of the Company's shares should have recourse against the Cardmember who failed to make the required payment, but this may be of questionable value to AESC in light of the time and costs of recovery.<sup>15</sup>

#### Pricing of Share Purchases

Rule 22c-1 under the 1940 Act prohibits a registered investment company from issuing any redeemable security, and

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<sup>14</sup> See Investment Company Act Release No. 6,366 (March 5, 1971).

<sup>15</sup> Conceivably, a court could refuse to enforce AESC's claim against a Cardmember who failed to make a required payment because of AESC's having violated the margin rules by extending the credit.

prohibits a principal underwriter of such security from selling, redeeming or repurchasing any such security, except at a price based on the current net asset value of such security that is next computed after receipt of an order to purchase or sell such security.<sup>16</sup> The staff of the Commission has permitted limited exceptions to the requirement that a purchase order be priced at the next determined net asset value, none of which are of precedential value in this instance. One exception would permit a money market fund to effect orders at the net asset value determined on the second business day after receipt of payment.<sup>17</sup> The rationale for permitting this practice was that, since money market instruments settle the day after the order to purchase them is given, time would be given to convert checks received into federal funds for the settlement of the purchase of money market instruments, which conversion was represented as generally taking two days to accomplish. Recent conversations with the staff of the Commission suggest that similar relief would not be available where portfolio securities in which the subject fund invested settled beyond one day. The second exception would permit a fund to have a two-day delay in pricing an initial purchase order where fund shares were sold in connection with a life

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<sup>16</sup> 17 C.F.R. § 270.22c-1(a) (1989).

<sup>17</sup> Scudder Managed Reserved, Inc., SEC No-Action Letter (April 21, 1977); see also Scudder Tax Free Money Fund, SEC No-Action Letter (July 16, 1982).

insurance policy.<sup>18</sup> The staff seemed to recognize that for an initial purchase, additional time would be needed to process the insurance application for such purposes as investigating the insurability of the covered person.<sup>19</sup>

Since the limited exceptions to the general rule do not apply in the instant case, it appears that investors in Company shares must receive the price next determined after the close of business on the New York Stock Exchange on the date fixed for the acquisition of shares by TRS or AESC on behalf of Cardmembers in the case of Alternative No. 1, on the day the Intended Investment Amount is received by AESC in the case of

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<sup>18</sup> Life Investors Management Corp., SEC No-Action Letter (September 6, 1974).

<sup>19</sup> Two other instances have arisen in which the staff of the Commission has permitted shares to be priced at other than the price next determined after receipt of the order, both of which have been characterized by the staff as "unique circumstances" where compliance with Rule 22c-1 was "highly impractical, if not impossible." Dreyfus Index Fund, SEC No-Action Letter (September 21, 1987). In Investment Company Institute, SEC No-Action Letter (December 8, 1975), a fund and its principal underwriter were permitted to hold a customer's purchase order and funds for an individual retirement account until the end of a seven-day disclosure period mandated by the Internal Revenue Service and consummate the investment at the price next determined after the end of such period. Templeton Global Fund, SEC No-Action Letter (September 7, 1982), involved a situation where no fund shares were available for investment at the time the order was received because of a limit on the number of shares that could be issued at any one time. In this case orders for the purchase of shares were held in a "suspense account" for up to 10 days and, if such orders were accepted during the period, shares were sold at the offering price next determined after acceptance of the order.

Alternative No. 2 and on the date a transaction occurs giving rise to a credit in the case of Alternative No. 3. It should be emphasized that Rule 22c-1 pertains to pricing the shares purchased under the Program; it does not require transmission of moneys to the Company's account at the time shares are priced.

An issue that may arise in the operation of the Program concerns so-called "as of" transactions. Given the volume of American Express Card billing payments received, and the possibility of a computer breakdown or other problem at the processing location, it may be impossible on certain days to process all orders for Company shares received on the day received, and a backlog may, therefore, occur.<sup>20</sup> The backlogged orders, however, cannot be processed on subsequent days at prices determined on those subsequent days without violation of Rule 22c-1 under the 1940 Act. Thus, the directors of the Company must determine when it is in the best

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<sup>20</sup> The staff of the Commission has stated that Rule 22c-1 requires investors to receive the price next determined after the mail containing a purchase order is received, rather than that determined after the mail is opened. See Dreyfus Liquid Assets, Inc., SEC No-Action Letter (January 15, 1975) and Dreyfus Index Fund, SEC No-Action Letter (August 21, 1987); see also Investment Company Act Release No. 5,569 (December 27, 1968) (announcing staff position that the time of receipt of an order by a retail broker, rather than the fund's underwriter, is controlling under Rule 22c-1). In order to reduce the risk that orders are not processed in a timely manner, perhaps the return envelopes of Cardmembers participating in the Program could be coded so that these envelopes could be processed first.

interests of the Company to stop sales and refuse such orders or to process them the next day or days "as of" a prior day's price. In the absence of a chronic backlog or of a material dilution of the Fund's existing shareholders, pricing on an "as of" basis would seem to be in the best interest of the Company should a backlog develop under the Program. If a chronic backlog developed because of the volume of transactions, the staff's position would probably be that sales be stopped and mechanisms put in place to handle ordinary order flow.<sup>21</sup> Another issue presented by the backlog problem is whether the cash flow from the purchase orders is available to the Company on a current basis. The Program should be designed to avoid a delay in the receipt of a material amount of the proceeds of the issuance of Company shares so that American Express is not profiting from "float" resulting from any excessive delay in investing assets in the Funds. It would not be necessary, however, that the Company receive proceeds from the sale of shares of the Fluctuating NAV Funds in fewer than seven calendar days from the time the purchase order is priced; federal funds from the sales of Fixed NAV Fund shares should be received by the Company on the day after the order is received.

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<sup>21</sup> See Letters from Stephen K. West, on behalf of the Investment Company Institute, to Kathryn B. McGrath, dated February 5, 1985 and October 11, 1985.



### Miscellaneous

Monthly Statement. To our knowledge, there is no statutory prohibition against calling the maximum amount to be invested by a Cardmember under the Program an "Investment Commitment" or a like term or against placing this term as a line item on the Monthly Statement immediately following the regular Card charges incurred, reflecting the Investment Commitment as part of the total payment due. However, we can imagine that a federal or state regulator might consider this approach to be confusing to Cardmembers and perhaps misleading. Consequently, we suggest that the language placed on the Monthly Statement referring to the maximum amount payable under the Asset Builder Program should avoid any suggestion that the amount is a fixed charge to, or an obligation or debt of, the Cardmember. Rather, the words selected should reflect the voluntary nature of the payment. In this regard, we would suggest using the term "Intended Investment Amount" or a like term, rather than the word "commitment" and that the line item showing such amount on the Monthly Statement be placed below the Card Total. If individual state regulators object to the formatting or terminology used on the Monthly Statement, it may be necessary to tailor the Statement sent into the state or states in question to comply with their particular requirements.

Asset Builder Program Fee. If a separate fee were to be charged to Cardmembers in connection with participation in the Asset Builder Program, two issues would be raised. A

payment to TRS could be interpreted as a transaction charge, lending support to the position that TRS was functioning as a broker and should be registered as such under the 1934 Act.<sup>22</sup> Such amounts -- whether paid to AESC or TRS -- also should raise the question whether they were a sales load within the meaning of Section 2(a)(35) of the 1940 Act.<sup>23</sup> In either event, it could be argued in response that any fee received was an administrative handling charge for the collection of funds and the transfer of those funds to TSSG and was not received in connection with the sale of shares. We recommend that this issue be discussed with the staff of the Commission, and perhaps a no-action letter be requested to confirm the nature of the charge before imposition in connection with the Program. The staff of the Commission typically responds within 30 days to a no-action request.

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22 The staff of the Commission has suggested that a charge imposed by a service agent for sending confirmations of mutual fund sales is a sales expense because it involved a charge for sales or promotional activities. Investment Company Institute, SEC No-Action Letter (June 13, 1973).

23 Section 2(a)(35), in part, defines "sales load" to mean the difference between the price of a security to the public and that portion of the proceeds from its sale which is received and invested and held for investment, less any portion of such difference deducted for trustee's or custodian's fees, insurance premiums, issue taxes or administrative expenses or fees which are not properly chargeable to sales or promotional activities. At the time that the Company's registration statement was initially reviewed by the Commission's staff, the issue was raised whether the \$50 annual account charge was a "sales load" under Section 2(a)(35) of the 1940 Act, the staff ultimately concluding that it was not.

Availability of Asset Builder Program for Purchases of Shares of Related Funds. There does not appear to be any legal impediment to the Asset Builder Program's being structured to permit the purchase of shares of mutual funds for which Shearson Lehman Brothers Inc. or IDS Financial Corporation serves as principal underwriter. Currently, Shearson-fund shares are available only to Shearson brokerage customers. For this reason, a correspondent relationship between AESC and Shearson would probably need to be established, or AESC could establish an omnibus account with Shearson, in order to effectuate share purchases under the Program.<sup>24</sup> Moreover, disclosure and other mechanical problems may arise were Shearson- or IDS-sponsored funds to be used in the Program. For example, the prospectus delivery requirement would be complicated by the fact most Shearson funds have separate prospectuses.

Hierarchy Among Asset Builder Program, Membership Savings and Privileged Assets. We are not aware of any legal constraints on establishing a hierarchy of investing and saving

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<sup>24</sup> In an omnibus account, shares of the Company would be held of record in AESC's name, and AESC would keep detailed records of the shares' beneficial owners. While presenting certain problems it would avoid a situation where the beneficial owner receives Shearson account statements -- a feature of an arrangement where AESC, as correspondent, "introduces" the account to Shearson on a "fully disclosed basis." Alternatively, it may be possible to open sales to non-Shearson customers, but we suppose that this procedure could require substantial changes to the transfer agency arrangements now in place for the Shearson funds.

with the American Express Card among the Asset Builder Program, Privileged Assets and Membership Savings. Of course, appropriate disclosure would need to be made of the order of investing and redeeming.

Issues under Alternative No. 3. Alternative No. 3 would operate like a sweep feature, automatically investing American Express account credit balances in Company shares. Sweep features have been implemented between securities brokerage accounts and money market funds upon full disclosure to securities brokerage account customers. Sweep features do not themselves raise legal concerns; however, they may cause practical problems. For example, sweeping credit balances tends to increase transfer agency and transaction costs due to the smaller average account size and transaction size. In addition, the client relations problems raised, as well as the possible economic losses resulting, when credit balances are swept into a Fluctuating NAV Fund are potentially enormous.<sup>25</sup>

#### CONCLUSION

The Asset Builder Program can be structured in a manner that satisfies the legal concerns discussed in this Memorandum. Assuming that a Program structured in this way is acceptable from a business and operational perspective, we

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<sup>25</sup> It should be noted that while the Fixed NAV Funds are money market funds that seek to maintain a constant net asset value of \$1.00, there can be no guarantee that they will be able to do so.

suggest that a meeting with the NASD to discuss the Program at an early stage would be helpful. The NASD is the regulator that is apt to be the first to become aware of comments of third parties about, and complaints by participants in, the Program and it would be important to have them fully aware of the Program. It is also the regulator that has the most direct interest in monitoring the promotion of the Program and the activities of AESC. It may also be useful to meet with members of the staff of the Commission solely for the purpose of informing them about the Program, which may forestall precipitate action on their part should they receive a customer or industry inquiry. Finally, consideration might be given to a similar meeting or informal conversation with members of the Investment Company Registration/Trading Practices Committee of the North American Securities Administrators Association (the "NASAA Committee") in order to reduce the possibility of objections arising at the state level.

\* \* \* \* \*

Attached to this Memorandum as an Appendix are question-by-question responses to the questions raised in the letter of Timothy J. Heine, Esq. dated August 16, 1990 to Burton M. Leibert, Esq. For ease of reference, the responses have been numbered to correspond with the numbering of the questions in that letter.

We trust that this Memorandum provides some guidance as you continue to explore the feasibility of the Asset Builder

Program. Please do not hesitate to contact Burton M. Leibert, Roger D. Blanc, Catherine J. Douglass or Rose F. DiMartino at (212) 935-8000 should you wish to discuss this Memorandum.

WILLKIE FARR & GALLAGHER

cc: Timothy J. Heine, Esq.

## APPENDIX

1. Investments in the Company can be solicited in TRS advertising pieces focusing primarily on the American Express Card, provided that the specific content and legend requirements of Rule 134 and/or Rule 482 under the 1933 Act are complied with and information about the Company is segregated from information about the Card.
2. TRS may collect moneys for investment in the Company, although doing so probably would require TRS to become registered as a broker-dealer under the 1934 Act as well as in various states. If a separate check in the name of the Company were issued for investing in the Company and forwarded to AESC or if AESC offices were set up at TRS operations centers to receive checks, TRS would not be required to obtain any separate license or registration in connection with the Program.
3. The formal characterization of TRS as an agent of AESC or TSSG would not seem to obviate the need for TRS to register as a broker-dealer were TRS to collect payments under the Program. Please note, however, that in this Memorandum we describe an informal discussion with a member of the Commission's staff who held out some hope for a change in regulatory outlook on such an arrangement.
4. Regulation G would bar TRS from extending credit for the purpose of buying Company shares, which credit is secured by these shares when the credit exceeds 50% of the current value of the shares. Section 11(d)(1) of the 1934 Act would bar AESC from extending any amount of credit or arranging for any extension of credit in connection with Company shares, for which it is the principal underwriter, that is secured by the shares purchased. Regulation T would limit any permissible extension of credit by AESC to 50% of the value of the margin security. The restrictions apply equally to the Fixed NAV Fund shares and the Fluctuating NAV Fund shares.
5. Under the existing position of the Commission, it would not be possible to collect moneys for investment in the Company at TRS Travel Service locations, unless TRS registered as a broker-dealer or AESC offices and employees were present in each such location. As indicated in 3 above, it appears that the staff may be willing to consider a change in its position on this matter.

6. The issues arising under Alternative No. 3 tend to be practical rather than legal, i.e., increased expenses to the Funds, customer dissatisfaction due to imposition of a sales load on small investments, public relations problems and potential risk of loss on reversal of transactions when customers fail to understand the operation of the "sweep" feature.
7. Except for disclosures in the Company's prospectus and solicitation materials, no specific disclosures need to be made concerning the Program, including on the Monthly Statement itself, although, from a business perspective, you may deem some information (such as a running tally of the value of investments) to be desirable.
8. Assuming that the Program is structured to have payments under the Program go to AESC instead of TRS and that no fee is charged to Cardmembers in connection with the Program, no regulatory relief is required under the federal securities laws to implement the Program. It would be advisable, however, to meet with representatives of the NASD and, possibly, the SEC and the NASAA Committee before implementation of the Program. Also, you may wish to discuss with AESC's accountants the increase in its net capital requirement that would result from its receipt of moneys under the Program and in payment of regular American Express Card bill charges.
9. Logistical, rather than legal, issues would arise if Shearson- or IDS-sponsored funds were offered in connection with the Program (e.g., prospectus delivery requirements and setting up a correspondent relationship between AESC and Shearson). Shearson- and IDS-sponsored funds that have fluctuating net asset values may present difficult business issues.
10. Assuming appropriate disclosure was made, no legal issues under the federal securities laws would arise if a hierarchy of investing and saving were established among the Asset Builder Program, Privileged Assets and Membership Savings.



# **EXHIBIT 2**

V B-34

MEMORANDUM

June 8, 1994

TO: Bill Stoltzmann  
FROM: Bruce Kohn BK  
RE: Use of American Express Card to Buy Securities

TRS has been advised that there are significant legal issues in use of The Card to buy mutual funds or other securities. There probably are ways to resolve the issues, but at significant expense.

Broker-dealer registration. TRS might be considered a broker-dealer if The Card is used to collect payment for securities. This might be resolved by trying to get assurances from the SEC and state regulators that TRS would not be treated as a broker-dealer--likely an expensive, time-consuming process and possibly not doable. An alternative might be to register TRS as a broker-dealer, which would impose burdens on TRS. Another alternative might be to have an affiliated broker-dealer receive the payments, which raises other significant business and legal issues.

Margin regulation. Margin regulations may apply because buying securities on The Card could be considered a loan by TRS. This might be resolved by not engaging in the securities transaction until the client pays the bill.

Detailed discussion. TRS lawyer Tim Heine gave me a confidential memorandum prepared by their outside counsel, Willkie Farr, when TRS was trying to market mutual funds called The American Express Funds to Cardmembers. The memo addresses these and related issues and discusses alternative solutions and the burdens associated with them.

I would be happy to discuss this.

Attachment: Memo to TRS from Willkie Farr

# **EXHIBIT 3**

## Compliance & Control Profile

Initiative Name: Invest on the Card

Required for Intake (This information is used to set up a meeting with the Business Architect Group):

Person Initiating Request: Nyla Andruss  
Phone Number: 612-671-3558  
Business Area Name: Enterprise Cross Sell (purchasing mutual funds on the AMEX credit card)  
Business Unit #: 1517  
This initiative is (select one):  
☐ A new product or service  
☐ A change or enhancement to an existing product or service  
☒ A new system or process  
☐ A change to an existing system or process  
☐ A CSCO Breakthrough Project  
☐ Other

Project Manager: Nyla Andruss  
Project Owner: Lisa Steffes  
Project Sponsor: Jeff Williams

Additional Resources: (people who will need to edit this form) 000nonam

Do you have a Compliance contact? ☐ Yes ☒ No

Legal Contact: Rockell Metcalf

Finance LFO contact: Mark X Riordan

Accounting contact: Mark X Riordan

Initiative Name: Invest on the Card

Initiative Start Date (mm/dd/yyyy): 05/18/2004

This initiative is currently in: Pre-PDP phase

The initiative is expected to rollout in: 4th qtr 2004

Provide a brief description of the initiative: We are requesting high level requirements to perform a test with Cardmembers offering Invest on the Card. In this test, we plan to leverage existing processes that are currently used for Privileged Assets. This means that clients can purchase mutual funds on their AMEX credit card.

Please attach any documents with more initiative details:



Invest on the Card- Test Plan.ppt

Identify the primary high-level deliverables & planned milestones of the initiative:

1. , due
2. , due

# **EXHIBIT 4**

MEMORANDUM

September 11, 1995

TO: Colleen Curran  
~~Rockell Metcalf~~  
Susan Miley  
Mary Ellyn Minenko  
Eileen Newhouse  
Susan Wold

CC (with only summary memo attached):

Gordon Eid  
Eric Marhoun  
Bill Stoltzmann

FROM: Bruce Kohn 

RE: Use of American Express Card to Buy Securities

As requested at the last lawyer meeting on Financial Services Direct, here is the Willkie Farr memo on paying with The Card. I'm also providing a summary memo I prepared last year for Bill. I would be happy to discuss.

Attachments

# **EXHIBIT 5**

From: MBANNE02--NYKSHR01

Date and time

96/02/19 06:40:00

From: Mike Bennett at NYKSHR01 1996/02/19 06:40

To: Norma Arnold at NYKESH01

cc: Jim Kerkow at IDSVM1, Rockell Metcalf at IDSVM1

cc: Colleen Curran at IDSVM1

Subject: Securities on the card

----- Message Contents -----

Norma,

I wanted to send you a quick update on the securities on the card project and also ask you to make two phone calls to help us secure support from the appropriate people in TRS operations. The phone calls are to Dave Tolley and Lou Lombardo; I will explain their purpose at the end of this e-mail.

Approach:

As we agreed at our last meeting, we are aggressively pursuing the two legal options, while at the same time working to design and implement a process to accommodate an April/May test. The

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implement a process to accommodate an April/May test. The objectives of the test are to:

- Develop an understanding of the impact, on response and conversion rates, of allowing customers to pay for Mutual Funds and PASA with the Card (the long term goal is to allow for the payment of all products)
- Learn what it would take, operationally to develop an industrial strength solution. We have come to realize that we will probably need to use some manual or PC based solutions for the test. Every time we talk about changing a systems process in remittance processing we are warned that this would basically preclude us from meeting our April goal.

As we stated in our meeting, we have prioritized the functionality as follows:

- + Mutual Fund - monthly contributions
- + PASA - monthly contributions
- + Mutual Fund - lump sums
- + PASA - lump sums
- + CDs
- + Other securities

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Payment method:

- + check
- + pay by phone
- + express net

We of course will attempt to deliver full functionality; however, this may not be possible for the test, so we established these priorities in case we need to make choices. At our next status meeting we will discuss which products we believe we will be able to offer for the test.

Status:

Option 1: Work with the SEC to develop a different interpretation of the process of receiving funds.

Rockell and Colleen have spent the past week investigating the history of the SEC's regulation which requires the broker dealer to "receive" the funds directly from the client. This coming week they will contract outside counsel (experts in SEC regulations) to help us prepare our presentation to the SEC. Rockell and I agreed that he and

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prepare our presentation to the SEC. Rockell and I agreed that he and Colleen would shoot to have some preliminary thoughts from outside counsel by Monday, Feb. 26, but he warned me that Monday, March 3rd would be more realistic.

Rockell has also raised the thought that we (AEFSD & AEFA) may need to prioritize between the items we are taking to the SEC for new interpretations. We may not want to push too hard on more than one or

two items at a time. The other topic Rockell was referring to was the new interpretations we are asking for in relation to on-line product sales and disclosures. He said that he would raise this flag if he foresaw a reason for concern.

Option 2: Utilize the exemption for banks, by legally moving remittance processing under the Centurion Bank umbrella.

Colleen is speaking with Bob Kraus regarding this topic. As you are probably aware, Amex is folding AEDC under Centurion bank. Several of the TRS operating centers (including NROC) are becoming bank ready by

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the TRS operating centers (including NROC) are becoming bank ready by June 1. This is necessary because they will be handling functions for Optima. We do not know if all of these changes mean it would be easier or more difficult to move remittance processing under Centurion Bank. We also are still investigating whether this would provide us with an exemption to the receiving funds rule. Colleen and Rockell should have spoken with Bob Kraus and developed some very preliminary thoughts by February 26th.

Option 3: Redesign our processes assuming the current regulatory environment and Amex legal structure.

We have made some progress in identifying and holding preliminary conversations with the key people within TRS operations. They are Vijay Ranganini and Jackie Gerham on Michael Cunningham's team, Dave Tolley in Operations new product development (Mary Crawford's team) and Mary Ann Ray (Treasury - global float management). Each of them was excited about the project and even thought it was something that they would like to use themselves. However, they each also cautioned us that their time was very limited and that we may need to clear it with their bosses if this project begins to take even a modest

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with with their bosses if this project begins to take even a modest amount of their time.

We will be holding a kick off/test design meeting on the week of 2/26. After that meeting we hope to have a better understanding of how we can make this test happen, who needs to be involved and how much of their time we will need. We will set up a status meeting with you after that meeting.

I spoke with Mike Cunningham about this project and while he thought it was a good idea, he was very skeptical about our ability to do it in time for an April test. He told me about all of the reengineering changes happening in remittance processing. This could be a concern going forward because I believe we will need Mike and his team to implement.

Norma, it would be very helpful if you would place two calls for us:  
1) Dave Tolley is waiting to hear from you before he puts us on the official project list that TRS operations maintains. This is an important list because Lou and team allocate resources according to the list and where you are on it.

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the list and where you are on it.

2) I think it may also prove helpful, if you placed a casual call to Lou Lombardo to inform him how important this project is to AEFSD. I believe this may prove helpful later if we need his help. The earlier we raise awareness of this project the better.

If you have any other ideas or questions please let me know. I will be out this week, but will be in on Monday the 26th. If you have any urgent questions regarding this project please call Jim Kerkow at (612) 671-2130. Also, Maria knows how to reach me.

Thank you for your support.

Mike B.

E N D O F N O T E

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# **EXHIBIT 6**

VB-34

## **InterOffice Memo**

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**To:** Mike Barnett                      Terri Hasson  
Robin Korn                              Mike Mathias  
Vijay Rangenini                      Mary Ann Ray  
Nancy Rosenberg                      Rich Sykes  
Dave Tolley

**cc:** Maria Flete

**From:** Jim Kerkow

**Date:** February 21, 1996

**Subject:** Securities on the Card Meeting

Thank you for your willingness to participate in our upcoming meeting! Though I don't know each of you personally, it sounds like we have quite a dynamic group and I'm looking forward to a lively and productive meeting! Each of you bring critical experience and insight to the project.

I've attached some background information on this project as well as our objectives for the meeting. Please review this information and feel free to call me at 612/671-2130 if you have any questions.

The meeting will be held in New York City at the World Financial Center on Tuesday, February 27, 1996 from 12:00 noon to 3:00 pm. The meeting will be held in the large conference room on the 45th floor and lunch will be served. If you have questions regarding the logistics of the meeting or location, please contact Maria Flete at 212/640-3988. If we can finish earlier, we will certainly try to do that, however we have much to accomplish and I want to plan ample time to ensure we make the most out of our time together.

Again, thank you in advance for your contribution and I will look forward to seeing you next week!



# **Securities on the Card Design Team Meeting**

**February 27, 1996**

**New York City**

## **Objective:**

The objective of this team is to develop and recommend an operational view of what a pilot of Securities on the Card should look like.

## **Deliverables:**

The team will deliver the following:

- 1. Develop "Stake in the Ground" hypothetical operational flow**
- 2. Develop set of questions which must be answered to validate the hypothetical position.**
- 3. Identify sources of information and data to answer questions.**
- 4. Gather data and information to prove/disprove hypothetical operation**
- 5. Make recommendation for pilot**

## **Meeting Agenda**

- Introductions**
- Overview and Boundaries**
- Design Proposed Operational Flow**
- Identify Open Questions and Resources**
- Plan Next Steps**

**Securities on the Card**  
**Page 2**

**Timeframe**

February 27 New York City	Initial Strategy Meeting Objective: Deliverables 1- 3
February 28 - March 8	Data Gathering
Mid March	Synthesis and Recommendation Meeting
Mid March	Final Report Published
Mid March	Mobilize Implementation Team

**Team**

(see attached chart)

## PARALLEL STRATEGIES

- *Develop* TEST OPERATIONAL PROCEDURES WITHIN CURRENT REGULATORY CONDITIONS
- ✱ REQUEST EXEMPTIVE ORDER FROM SEC AND NASD
- PURSUE OTHER PAYMENT PROCESSING IDEAS

## **TEST OPERATIONAL PROCEDURES WITHIN CURRENT REGULATORY CONDITIONS**

### **Factors to Consider**

- There will be NO extension of credit by American Express to any cardmember for the purpose of purchasing securities.
- Timeliness of the trade is critical due to as-of costs.
- The receipt of funds intended for securities purchases is an activity subject to broker/dealer registration and regulation and must therefore be conducted by a registered B/D.
- Process will likely be manual and therefore inefficient and expensive.
- There are significant prospectus disclosure issues to be resolved.

### **Benefits**

- We will begin immediate progress toward solving the operational issues associated with this project.
- We will be able to test the impact on sales in the 2nd quarter.

## REQUEST EXEMPTIVE ORDER FROM SEC AND NASD

### Factors to Consider

- An exemptive order would not eliminate all the operational issues.
- The process of researching precedent, presenting a compelling argument and obtaining a ruling could easily take 60-90 days.
- We will be approaching the <sup>SEC</sup>NASD on a number of issues relating to Virtual Bank, and this may unduly jeopardize our credibility on other issues.

### Benefits

- We may be successful in obtaining an exemptive order, in which case some of the operational aspects of going to scale with this service would be resolved.

## **• PURSUE OTHER PAYMENT PROCESSING IDEAS**

- 1. A BANK ENTITY OF AMERICAN EXPRESS MAY HAVE AN EXEMPTION FROM BD REGISTRATION WHICH WOULD ENABLE IT TO ACT AS THE PAYMENT CONDUIT.**

### **Benefits:**

It may be easier for TRS to operationalize and meet regulatory requirements through AEDC or Centurion than through AESC.

- 2. A THIRD PARTY VENDOR COULD BE CONTRACTED TO PROVIDE PAYMENT PROCESSING WHICH WOULD NOT IMPACT TRS PROCESS, BUT WOULD STILL MEET WITH REGULATORY ISSUES.**

### **Benefits:**

There would be no significant impact on TRS remittance processing.

- 3. FOR TEST PURPOSES, A COMPLETELY INDEPENDENT OPERATION COULD BE ESTABLISHED, UTILIZING AEFA PAYMENT PROCESSING.**

### **Benefits:**

There would be no significant impact on TRS remittance processing and it could operate within current regulatory requirements.

# **EXHIBIT 7**

## VIEW THE NOTE

E01

From: E16605 --IDSVM1

Date and time

04/03/96 12:52:21

To: E33435 --IDSVM1 Rockell Metcalf

From: Jim Kerkow - Client Relations

Subject: Personal Investment Project Technology Mtg Minutes

FYI

Jim

(PROFS: JamesK or call EXT. 2130)

\*\*\* Forwarding note from NROSEN --NYKNOT01 96/04/03 14:30 \*\*\*

From: Nancy Rosenberg at NYKNOT01 1996/04/03 14:30

To: Jim Kerkow at IDSVM1, Richard Sykes at IDSVM1

To: Adam Rothschild @ AMEX at NYKNOT01

To: Mike Bennett @ AMEX at NYKNOT01, Amy Piper @ Amex at NYKNOT01

To: Steven Gaswirth @ AMEX at NYKNOT01

Subject: Personal Investment Project Technology Mtg Minutes

----- Message Contents -----

What follows is a summary of this morning's conference call regarding the  
Technology Impact for the Personal Investment Project:

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We agreed on the following next steps:

- (1) Complete high level business plan for Technology group - N. Rosenberg, A. Rothschild, M. Bannett, J. Kerkow
- (2) Schedule a Feasibility kick-off meeting - N. Rosenberg
- (3) Complete prep materials for meeting - M. Bannett, J. Kerkow, N. Rosenberg
- (4) Schedule a PDP meeting to define the high level business needs and define the scope of the project
- (5) Determine who should be Technologies liaison - A. Piper, S. Gaswirth
- (6) Follow-up with Treasury on ghost fund (i.e., if they can transfer money to AEIS before funds are actually received, we may be able to expedite money movement) - J. Kerkow

The following key issues will need to be addressed:

- (1) Inorder to avoid broker-dealer registry requirements, we will need to ensure that money movement is completed in less than 24 hours
- (2) We must investigate the link between AEFA and AEIS (i.e., once the payment has been received in AEIS, we will need a system to sort and allocate the investment funds into the appropriate investment vehicle)

PF1 Alternate PFs PF2 File NOTE PF3 Keep PF4 Erase PF5 Forward Note  
PF6 Reply PF7 Resend PF8 Print PF9 Help PF10 Next PF11 Previous PF12 Return

VIEW THE NOTE

E01

allocate the investment funds into the appropriate investment vehicle)  
(3) To what extent should SBS and AEFA be involved in the project. They  
will both be able to leverage this functionality and help us make a  
strong business case to support this initiative.

Please let me know if I have missed or misrepresented anything.

Thanks,  
Nancy

E N D O F N O T E

PF1 Alternate PFs PF2 File NOTE PF3 Keep PF4 Erase PF5 Forward Note  
PF6 Reply PF7 Resend PF8 Print PF9 Help PF10 Next PF11 Previous PF12 Return

# **EXHIBIT 8**



# Memorandum

Date: April 15, 1996  
City: New York  
Office: CCSG  
Product Development

Subject: Securities on the Card Meeting Materials  
TO: Distribution  
FROM: Nancy Rosenberg

---

The purpose of this memo is to provide background information on the New Product Development process and the Securities on the Card project for the Concept kick-off meeting scheduled for Friday, April 19th from 9:00 to 10:30. Attached please find:

- Project Description/Rationale
- NPD Process Overview
- Phase Gate Process Map
- Gating Forms
- Roles and Responsibilities
- "Rules of the Road"
- Meeting Agenda

I am looking forward to seeing you at next week's meeting. In the meantime, if you have any questions, please feel free to contact me at X3968.

# Personal Investment "Card"

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## Project Objective:

To develop a platform that will allow Cardmembers to bill their investment contributions to the Card

This platform can then be marketed for multiple purposes (e.g., increase CIF, increase existing CM's loyalty/retention, increase VB customers' investment contributions/customer satisfaction)

## Project Rationale:

Both charge and lending Card concepts with this functionality ( i.e., The Personal Investment Card and The Smart Saver Card) have had high appeal when tested qualitatively

American Express Financial Services Direct's customers have repeatedly requested this functionality

# Customer Input (Based on Qualitative Research)

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American Express brand fits with investment

Consumers have a need for more savings

● Consumers have a need for control (i.e. forced savings/discipline)

Consumers want security and guarantees when investing (i.e. simple, risk-free/low risk investment options)

Respondents, especially younger customers, have very little knowledge about financial planning and want access to simple, easy to understand financial advice

Card concept is most appealing to younger prospects and CMs who are inexperienced investors

● Younger respondents indicate they would use Card as primary savings plan, while older respondents indicate it would be for supplemental savings

Respondents with small children viewed this concept as a way to save for college. Others saw the Card as a means to save for retirement, down payment for a house or car, or just a general savings account

\*\* See Attached for detailed research results

# Secondary Research

---

'93 YCS Study of  
20 - 49 year olds:

21% are not saving anything

72% say saving for the future is their single biggest worry

77% would welcome new ways to save

31% have less than \$10,000 in savings/investments

American

Demographics:

60% of 30 - 49 yr. olds would like to save more for retirement

AARP:

40% of 45 to 59 year olds have not saved enough or anything for retirement

Smart Money:

estimates that a college education will cost more than \$200,000 by 2013

Sept 1995

23

## The American Express Personal Investment Card

- Automatic savings through the Card. No minimum initial investment. Any amount \$25+ can be invested each month. CM may choose from no-load money market, stock or bond funds. All funds provide a competitive rate of return.
- No transaction fees.
- Quarterly report.
- Toll-free access to professional financial advice.
- Access to a stock market fund which guarantees a return from 4% to 12%.



Other Investment Trade-Offs Probed with Respondents

- Automatic deposit of a \$50 US Savings Bond each year CM spends \$1,000.
- 1% (2% also tested) matching funds on all CM spending.
- Guaranteed 7% return on CM investment during first year.
- 5% of CM spending matched by Savings Partners, i.e. Hertz, Spiegel, Days Inn, Teleflora and MCI and automatically deposited into account.
- Premium on any investment based on spending, i.e. \$1,000 spending equals 1% additional guaranteed return, \$2,000 spending equals 2% additional guaranteed return, \$3,000 spending equals 3% additional guaranteed return.
- Fee waiver when contributions reach \$500.

## The American Express Personal Investment Card

Shown to:

Zero Billers (2)

Low Spenders (3)

Prospects (3)

### Reaction to the Personal Investment Concept

This concept with the 4-12% stock market fund option had substantial appeal across all groups, both Cardmembers and Prospects. Essentially it responds to the needs of these consumers to have a systematic, enforced savings program that offers a better return than a passbook savings account without the risk of stock market investing.

These consumers are not financially sophisticated. They have difficulty forcing themselves to save and they have little knowledge about choosing investments. Some have no savings. In many cases, their most significant investment appears to be their company 401k plan. Also, some are intimidated by stock brokers since any investment they make would be considered small. This concept provides comfort for the novice.

The 4-12% stock market fund option was clearly preferred to the other options because it offered a guaranteed return that exceeded that of a savings account and a potentially higher return in years when the stock market performed well. Further, there was no risk to principal.

Other savings features offered as trade-offs did not have these advantages. Several were contingent on Cardmember spending and many could not (or would not) estimate their potential spending or disliked the idea of being rewarded for spending.

The "unknown" with this concept is whether it would promote or discourage CM spending. As noted, many currently limit their use of the Card because it does not allow for revolving. Designating a specific sum to be saved each month may inhibit any other spending. However, among Zero Billers the concept does provide utility to a Card they have begun to question.

The younger audience, Prospects, in particular, had substantial interest in the Card although some may reject paying an annual fee for a savings program alone. Some have previously rejected the AmEx Card based on fee. There may have to be more utility, in addition to the savings plan, in order for them to acquire the card.

Of the names exposed to the groups, Personal Investment Card was chosen for its clarity and simplicity. Personal Savings Card also exhibited some strength. But, investment had the advantage of alluding to a higher rate of return. Savings seem to be identified with banks, which historically have paid lower returns than investments through other channels.

Feb 1995

## Smart Saver Card

15

The Smart Saver Card offers:

- Investment Account. CMs can save a minimum of \$50/month. That amount will automatically be charged each month to the Smart Saver Card bill, then invested in one of 3 options: Money Market fund, Mutual fund, or Tax-Free Government Bond fund.

Additionally, when the CM establishes this Investment Account, American Express will rebate 2% of total card spending and deposit it into the Investment Account each month.

- The Investment Account is flexible enough to change as the CM's needs change. Funds can be transferred from one fund to another to accommodate any change in investment goals.
- Goal-Related Information including travel planning and discounts or college planning.

### Smart Saver Card

This concept elicited a very positive response across many groups. To many, this represented a unique idea in credit cards, saving and spending with one card. Those with small children (under 10 years) viewed this concept as a way to save for college and welcomed the disciplined savings as well as the information aspect. Others saw the card as a means to save for retirement, down payment for a house or car, or just a general savings account.

The \$50 minimum did not represent a problem to those interested in the idea. All felt they could save this amount without difficulty. The added 2% rebate insured the card would be used with frequency.

Respondents want a variety of investment options and no fees for changing among funds.

Those less enthusiastic to the idea felt they have enough options for saving at the present time and see no reason to do so though a credit card. Further, some would like a more "hands-on" approach to investing and would prefer to meet with an advisor in person.

Dec 1994

20

### Family Investment Card

A new card from American Express designed to help CMs meet the college planning needs of their family, including:

- Access to a financial planner who will help the CM develop an estimate of projected college tuition requirements and design a long-term savings and investment strategy.
- College investment account established in the child's name with a minimum monthly investment of \$25 to various investment vehicles. Fees and minimum investment amounts are waived.
- Flexibility to add to this account by phone
- 1% of total annual spending on the Card is matched by AmEx and applied to the account.



### Family Investment Card

This concept had strong appeal among the parents of young children. Although the savings and investment elements could be used for other goals, it had less appeal to other CMs. Many feel they are saving adequately through other channels.

The college savings aspect is compelling because many parents are overwhelmed by the cost of an education and know that unless they are disciplined in their investment strategy, the funds will simply not be available. They seek:

- financial guidance and planning on the amount necessary for college;
- access to a wide variety of funds/investments; and the
- ability to change among funds.

CMs were positive to the 1% matching funds and some felt it would encourage use of the Card. However, this may be offset by the monthly commitment billed to the Card and their need to revolve additional purchases.

10/3/95

## SMART SAVER

### DESCRIPTION

**NOW THERE'S A CARD THAT HELPS YOU SAVE FOR YOUR FUTURE AND REDUCES YOUR CREDIT CARD INTEREST CHARGES.**

**WHEN YOU RECEIVE THE CARD, YOU DECIDE HOW MUCH YOU WANT TO SAVE EACH MONTH (MINIMUM \$50). YOUR MONTHLY STATEMENT WILL REFLECT YOUR SELECTED SAVINGS AMOUNT IN ADDITION TO YOUR MINIMUM CREDIT CARD PAYMENT.**

**YOU'LL HAVE THE FLEXIBILITY TO CHANGE YOUR MONTHLY CONTRIBUTION AT ANY TIME OR MAKE ADDITIONAL INVESTMENTS INTO YOUR ACCOUNT. YOUR SAVINGS WILL EARN A COMPETITIVE INTEREST RATE.**

**AT THE END OF EACH YEAR, YOU WILL RECEIVE A 10% REBATE ON THE INTEREST YOU HAVE PAID ON THE CARD AS AN ADDITIONAL DEPOSIT TO YOUR SAVINGS ACCOUNT.**

**INTEREST RATE: 7.9% FOR THE FIRST YEAR; THEREAFTER PRIME + 8.75% (CURRENTLY 17.5%)**

**OVERALL: THIS CARD APPEALED TO CONSUMERS WHO NEEDED MOTIVATION TO SAVE. THOSE WHO EXPRESSED AN INTEREST IN THIS CONCEPT WERE EXTREMELY INTERESTED.**

- ◆ **HOWEVER, A NUMBER OF CONSUMERS DID NOT FEEL THAT THIS CARD PROVIDED THEM WITH SUBSTANTIAL BENEFITS ABOVE AND BEYOND WHAT THEY ALREADY HAVE.**

SMART SAVER (CONT'D)

POSITIVES

- A FEW CONSUMERS WERE VERY ENTHUSIASTIC ABOUT THIS CONCEPT. THEY FELT THAT THIS CARD WOULD MOTIVATE THEM TO SAVE.

*AUTOMATICALLY SENDING IN AN  
ADDITIONAL AMOUNT TO BE SAVED ALONG  
WITH MY MONTHLY PAYMENT SEEMS LIKE  
A RELATIVELY PAINLESS WAY TO PUT  
SOME ADDITIONAL FUNDS AWAY.*

*THIS WOULD MOTIVATE ME TO START  
SAVING. I LIKE THIS IDEA VERY MUCH.*

- THESE CONSUMERS WERE ACCUSTOMED TO PAYING BILLS; HOWEVER, THEY DO NOT TEND TO SAVE MONEY. THIS CARD OFFERED A WAY TO SAVE THAT IS CONSISTENT WITH THEIR CURRENT BEHAVIOR.

*I CAN PAY A BILL EASIER THAN SAVING  
\$50 A MONTH.*

- 10% OF THEIR INTEREST CONTRIBUTED BY AMERICAN EXPRESS WAS AN ADDED INCENTIVE.

*10% OF MY INTEREST PAID BY THE CREDIT  
CARD COMPANY IS NICE.*

- A NUMBER OF CONSUMERS LIKED THE REBATE, BUT WERE NOT SURE IF THEY WOULD BE INTERESTED IN THE SAVINGS ACCOUNT.

*10% REBATE ON INTEREST PAID IS NICE,  
BUT IF I DON'T WANT THE SAVINGS  
ACCOUNT, DO I STILL GET THE REBATE?*

*THE REBATE IS INTERESTING, BUT I  
PROBABLY WOULD NOT USE THE SAVINGS  
PLAN.*

SMART SAVER (CONT'D)

SOURCES OF CONFUSION

- SEVERAL CONSUMERS WERE CONFUSED ABOUT HOW CARD ACTIVITY AND, IN PARTICULAR, PAYMENT BEHAVIOR, WOULD OR COULD AFFECT THE MONEY IN THE SAVINGS ACCOUNT.

*IF YOU DON'T USE THE CARD, WHAT HAPPENS?*

*WOULD THEY TAKE IT OUT OF YOUR SAVINGS IF YOU PAID YOUR BILL LATE?*

- MANY WERE ALSO CONCERNED WITH THEIR ABILITY TO ACCESS THIS SAVINGS ACCOUNT.

*IT SOUNDS COMPLICATED TO WITHDRAW MONEY.*

*CAN YOU WITHDRAW THIS MONEY?*

## SMART SAVER (CONT'D)

### NEGATIVES

- MANY CONSUMERS INDICATED THAT THEY SAVE ELSEWHERE, AND DID NOT NEED OR WANT A CREDIT CARD FOR SAVINGS.

*I COULD JUST USE MY SAVINGS ACCOUNT.*

*I LIKE TO DO MY OWN BANKING, KEEPING MY SAVINGS SEPARATE FROM MY CREDIT CARD PAYMENTS.*

- OTHERS FELT THAT THEY WOULD GET A HIGHER RETURN ON THEIR MONEY FROM CD'S OR THEIR 401K. THEREFORE, THIS DOES NOT MAKE FINANCIAL SENSE FOR THEM.

*I HAVE A 401K AT WORK AND CD'S AND OTHER WAYS OF GETTING MORE MONEY THAN I PROBABLY WOULD FROM THIS.*

*I WOULDN'T BE INTERESTED BECAUSE I SAVE THROUGH A 401K. YOU COULD ALSO HAVE SAVINGS WITH A HIGHER INTEREST RATE OR A BOND.*

- SOME CONSUMERS ALSO INDICATED THAT IT DOESN'T MAKE FINANCIAL SENSE TO PUT MONEY INTO SAVINGS RATHER THAN PAYING DOWN THEIR BALANCES.

*THE CARD RATE IS MUCH HIGHER THAN COMPETITIVE EARNED INTEREST; THEREFORE, THIS COULD COST YOU MONEY IN THE LONG RUN.*

*THERE'S NO SAVINGS IF YOU'RE PUTTING OFF PAYING YOUR BALANCE.*

SMART SAVER (CONT'D)

NEGATIVES (CONT'D)

- MANY ALSO FELT THAT THE INTEREST RATE ON THE CARD WAS VERY HIGH.

*I DON'T LIKE THE 17.5% INTEREST RATE.*

*THE INTEREST RATE ON THIS CARD IS VERY HIGH.*

- SOME CONSUMERS DID NOT FEEL THAT THE 10% REBATE WOULD AMOUNT TO MUCH OR PROVIDE SUFFICIENT INCENTIVE TO SAVE THROUGH THIS MEANS.

*IT SOUNDS SEMI-GOOD, THOUGH 10% OF YOUR INTEREST IS PETTY.*

*THERE'S NOT ENOUGH INCENTIVE TO USE THE SAVINGS ACCOUNT.*

- IN THE END, MANY FELT THAT THIS CARD DID NOT PROVIDE THEM WITH ANY REAL BENEFITS.

*I'D END UP WITH PRETTY MUCH WHAT I HAVE RIGHT NOW WITH MY PAYROLL DEDUCTION AND A CREDIT CARD WITH A LOWER RATE. THE ONLY PLUS IS THE 10% REBATE. BUT THIS CARD HAS A HIGHER RATE, SO I'M REALLY NOT GETTING ANYTHING FROM THIS.*

**Introducing the Personal Investment Card from American Express that gives you easy access to investment opportunities.**

This new Card is linked to a tax-free money market account and offers several convenient investment options, allowing you to invest on a monthly basis.

- Invest as little as \$25 per month, on a regular basis, in Mutual Funds, Savings Bonds, Tax-Free Bonds or Equity Funds through American Express Financial Services. American Express will waive the fees and high minimum transaction amounts normally associated with these investments.
- Invest in a specially designed fund that guarantees your rate of return (tied to a stock-market index) and secures your principal against a market downturn.
- Earn a competitive interest rate on your investments and money market account balance.
- Access to cash in your money market account by check or by using the Card at 74,000 ATM's worldwide.
- Toll-free access to American Express Financial Services advisors to help you make investment and cash management decisions.
- A monthly statement which details your Card purchases as well as your money market and investment balances.
- The convenience of paying your bill by phone every month through an electronic funds transfer from your checking account.

Along with these investment services, you'll also enjoy traditional American Express benefits, such as 24-Hour Customer Service, Express Cash, copies of your charge receipts included with your monthly statement, Emergency Card Replacement and no pre-set spending limit.

#### D. Personal Investment Card

A new card from American Express that offers CMs access to investment opportunities, including:

- Minimum monthly investment of \$25 to various investment vehicles, including mutual funds, savings bonds, tax-free bonds or equity funds. Fees and minimum investment amounts are waived.
- Investment in a fund tied to S&P index that secures the principal against loss
- Competitive rate on investments and money market balance
- Access to cash in account through ATMs
- Toll-free access to AmEx Financial Services Advisors
- Monthly statement of purchases as well as investments
- Optional direct debit bill payment

This concept had appeal for both Younger and Older CMs.

#### Strengths

- Quite a few remark about the lack of a downside risk to the plan. This encourages them to participate. Additionally, it makes new investors less apprehensive about entering the market. However, these CMs were focusing on only one of the investment options the plan would offer. Others would not be risk free.

*"It's tied to an index, so you can't lose much."*



*"This is almost idiot-proof. You can't lose; you can only gain."*

*"It makes it very easy to invest in something you have confidence in. You don't have to worry about the risk factor, because the worst thing is you break even."*

- The enforced savings appeals to many of these CMs. Many complain they find it difficult to remember to save money, or they find it "impossible," given their other expenses. They see this concept as removing the choice for savings; treating the money put aside as another bill which must be paid. Ideally, the amount will be added to the monthly statement.

*"It's an easy and painless way to put money aside and forget about it."*

*"It would be advantageous if, as you pay the bill, you can just add in whatever you want to send that month."*

- The low initial and subsequent monthly investment likewise intrigues CMs. Several describe the frustration of wanting to invest, but being deterred by high entry minimums couple with high minimum transaction amounts.

*"I like the small investment. Anybody can take an extra \$25 and put it away."*

- Group members want the opportunity to vary the amount they save. Specifically, they accept the concept of a minimum of, say, \$25 per month, but if they have some extra cash one month, they would like to be able to add that to the amount saved.

*"It would be nice to put in varying amounts, depending on the monthly situation."*

*"It would be nice if you find you have an extra \$100 one month, you could just throw it in."*

- Absence of sales fees and minimums are other positive aspects of the plan. This presents an advantage, especially to the small investor.

*"This reaches consumers who may not have even thought of investing money."*

*"This is easier than reading everything, meeting with a financial advisor or going to a financial institution."*

- While most can envision participating in this, the Younger CMs expect to use this as their primary savings plan, while the Older group members view this as a supplemental one. Also, those with 401K plans see this as an additional means of retirement or long-term savings.

*"I would use this as primary savings, because I'm an awful saver."*

*"I would use this as a side investment, since I'm already invested elsewhere."*

- Promising easy access to funds appeals to a number of these CMs. They feel it is important to gain access without penalty, should the funds be needed.

*"I like the easy access, in case I need it. Availability would be important to me."*

- The concept has a strong imagery link to the American Express financial heritage but is not strongly related to card usage. Nonetheless, linking savings to The Card strengthens the relationship with the CM and potentially lessen the chance of attrition.

### Weaknesses

- The ease of access to funds polarizes respondents. While some appreciate it, quite a few believe the account should be regarded as "untouchable" and not used frivolously. Therefore, they don't want the temptation offered by ATM access.

*"I don't like the easy access, because that would be too much of a temptation."*

*"If you're going to invest money, why do you want an easy way to take it out? It defeats the whole purpose of investing."*

*"I don't want it so locked up there's penalties if I touch it, but I don't want it too easy either."*

- There is little evidence the concept would alter Cardmember use of AmEx. Even when the concept was offered with a 1% cash rebate on card spending, there was minimal appeal. Moreover, there is the possibility this concept might actually diminish usage since the commitment to save may override the desire to spend on The Card in any given month.

*"I might use the card less, depending on how much I'm putting aside every month. Knowing I have to pay off the balance at the end of the month, I might not use it to go out to dinner one night."*

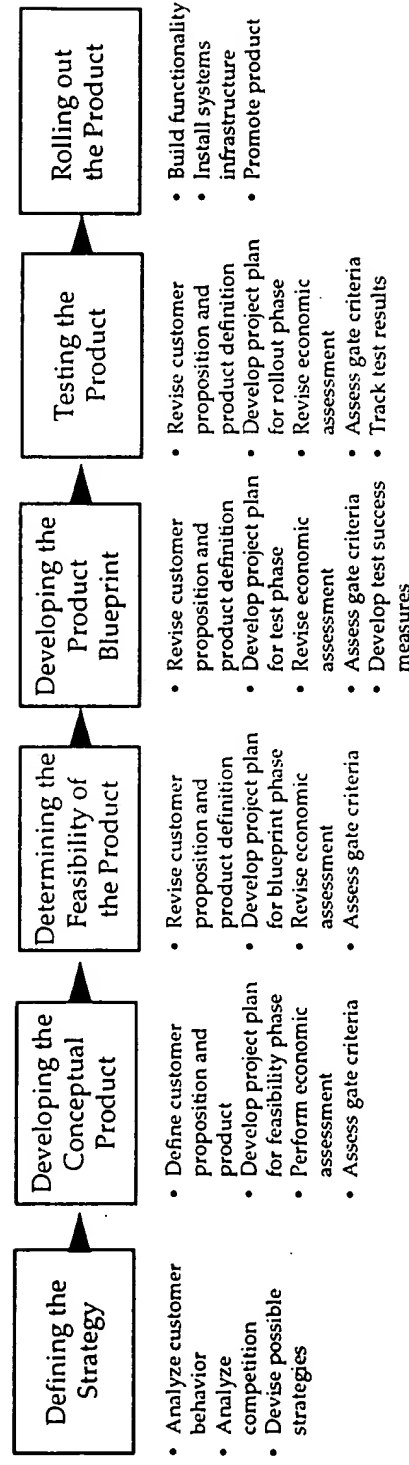
- Finally, there is some resistance among CMs who feel they have sufficient savings. They do not feel the need for additional savings opportunities.

*"I already have a plan through work. It just goes in automatically."*

*"I have something very similar to this at work. I have something taken out of the check already."*

# New Product Development Process

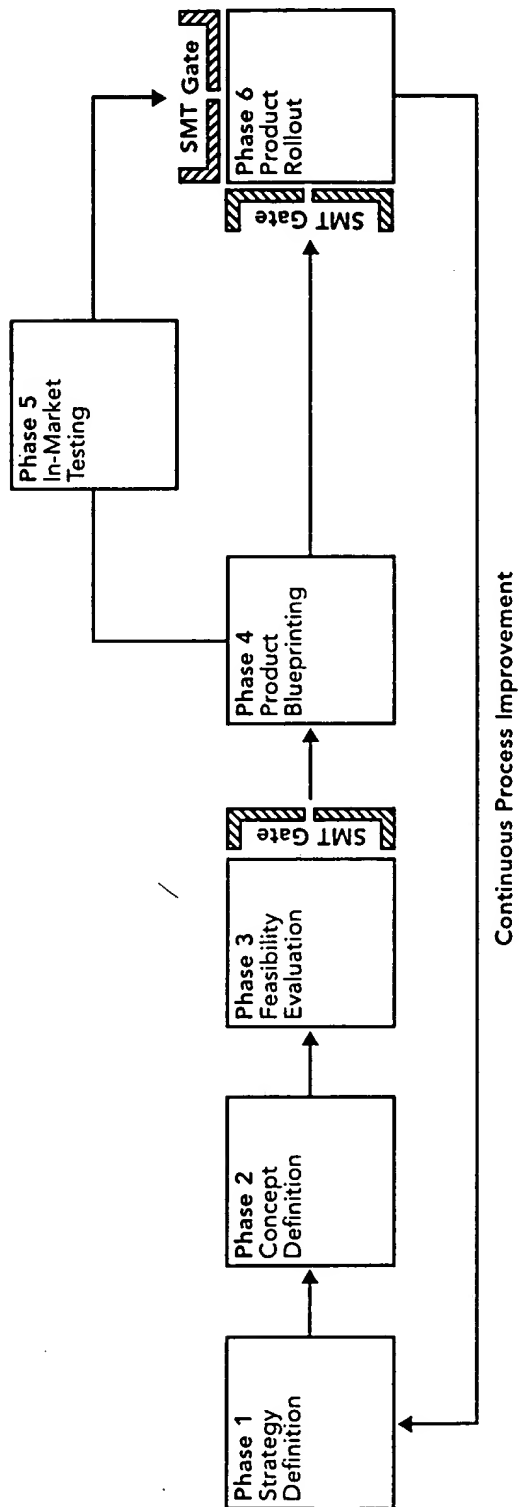
Consumer Card Services Group has adopted a standard phase-gate approach to product development which is consistent with American Express' worldwide product development model. The process consists of six phases, each with its own discrete action steps:



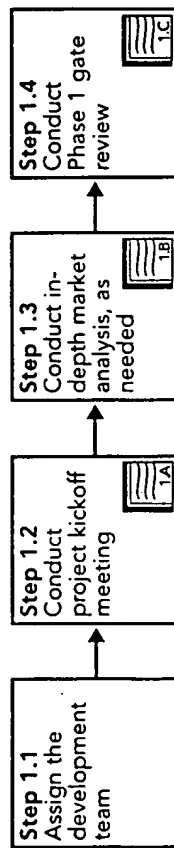
At each successive phase in the process, more detail is added to the concept and the gate criteria, taking the product from a general concept to a working product. In order to move from one phase to the next, specific **gate criteria** must be evaluated before a formal "go/no-go" decision is made.


# New Product Development

## Phase/Gate Process Map

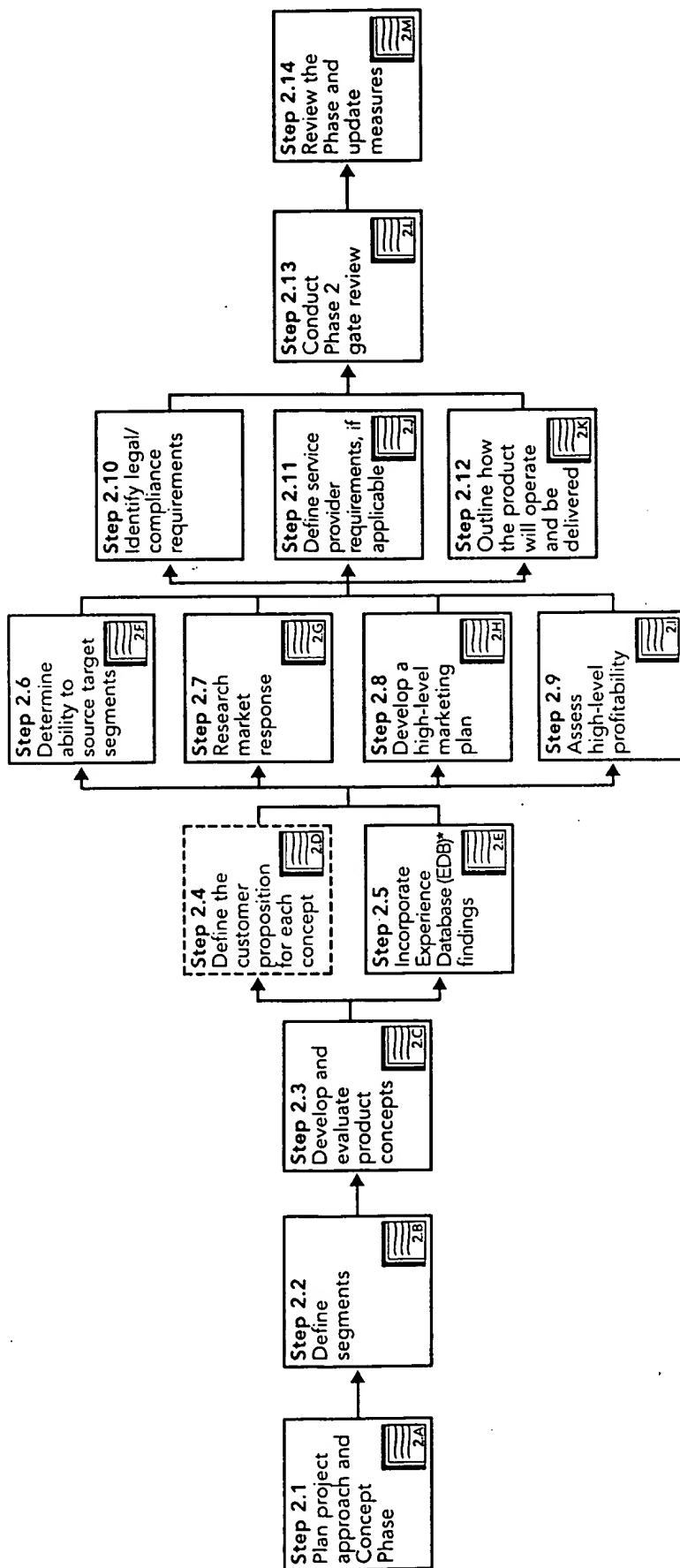


# Phase 1: Strategy Definition



Output Documents		Lead Responsibility
	1.A Team Mission Statement/Charter .....	Team Leader
	1.B Market Analysis Validation .....	NPD
	1.C Gating Forms and Process Measures Document .....	Team Leader

# Phase 2: Concept Definition

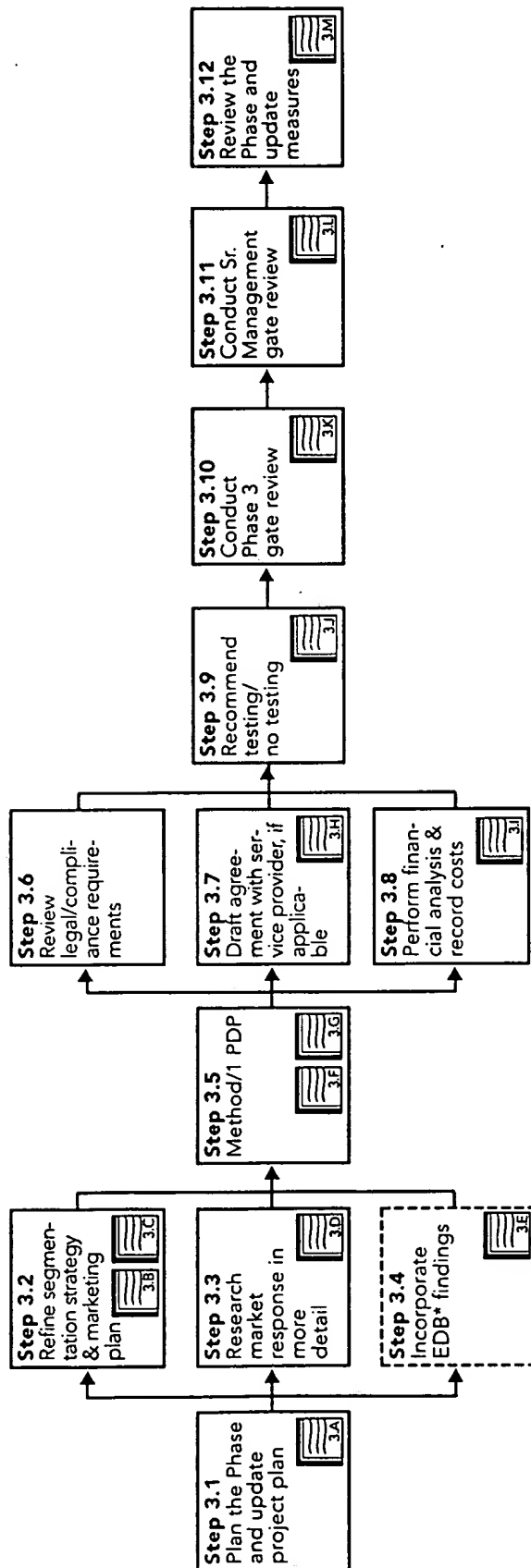


Output Documents	Lead Responsibility
2.A Project Plan	Team Leader/Project Manager
2.B Target Segment Definitions	NPD
2.C Concept Evaluation	NPD
2.D Customer Proposition	NPD
2.E EDB Implications and Recommendation Form	NPD
2.F Segment Sourceability Sizing	Risk Management
2.G Market Response Assessment	Marketing Research
2.H High-Level Marketing Plan	NPD
2.I Financial Assessment Document	Finance
2.J Vendor Requirements Document	NPD
2.K Tech/Ops High-Level Business Plan	Technologies/Operations
2.L Completed Gating Forms	Team Leader
2.M Process Measures Document	Team Leader

\* Experience Database is under development.



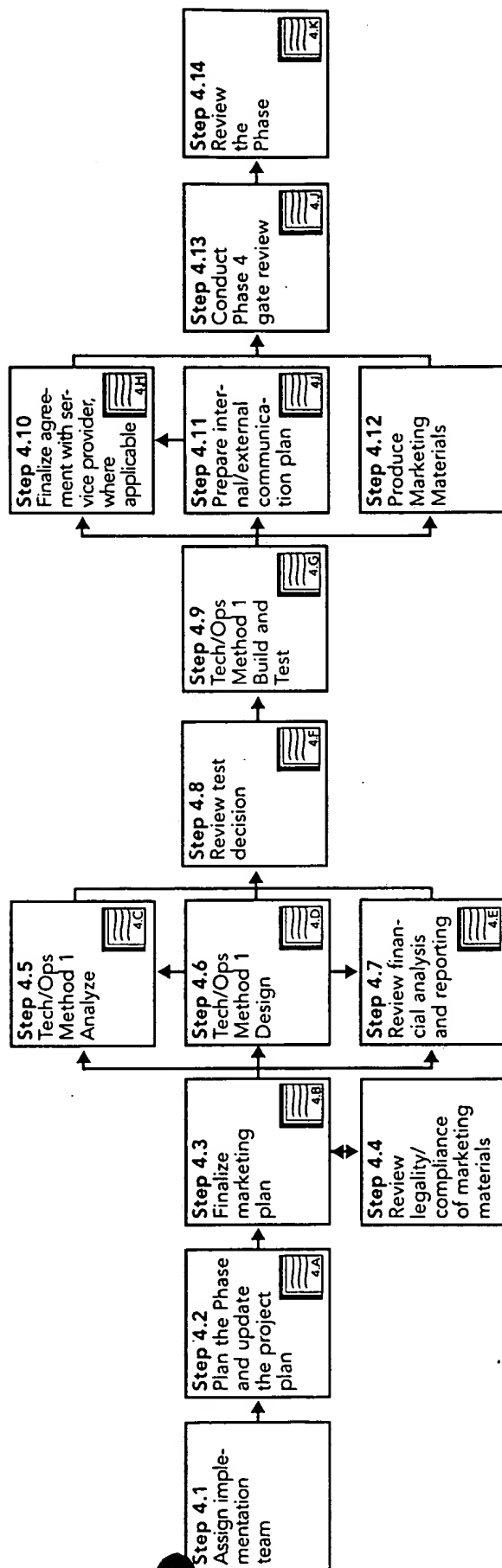
# Phase 3: Feasibility Evaluation



Output Documents	Lead Responsibility
3.A Project Plan	Project Manager
3.B Target Segment Definitions	NPD/Risk Management
3.C Marketing Plan	NPD
3.D Market Response Assessment	Marketing Research
3.E EDB Implications and Recommendation Form	NPD
3.F Initial Impact Request	Technologies/Operations
3.G Project Definition Report (PDR)	Technologies/Operations
3.H Draft of Vendor Agreement	NPD
3.I Financial Assessment Document	Finance
3.J Product Delivery Risk Assessment and Recommendation	Team Leader
3.K Completed Gating Forms	Team Leader
3.L Signed Gating Forms	Team Leader
3.M Process Measures Document	Team Leader

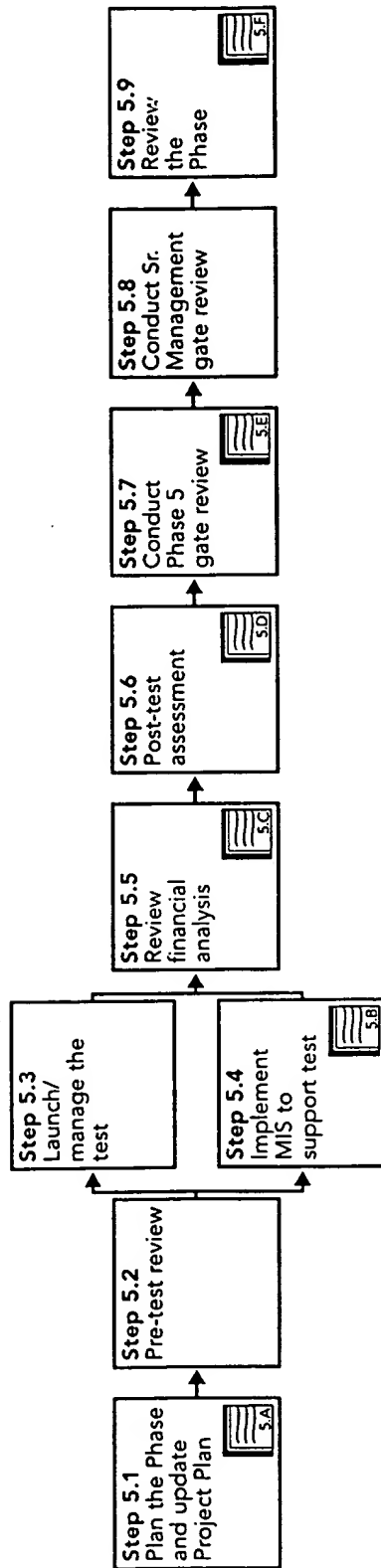
\* Experience Database is under development.


# Phase 4: Product Blueprinting



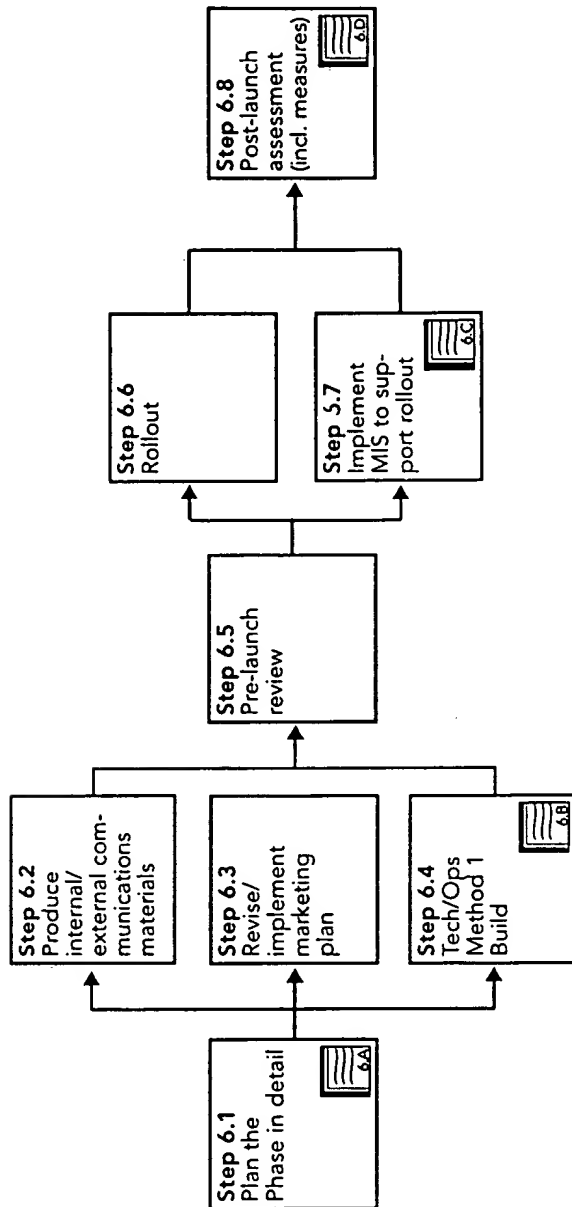
Output Documents	Lead Responsibility
4.A Project Plan	Project Manager
4.B Marketing Plan	NPD
4.C Business Systems Analysis Report (BSAR)	Technologies/Operations
4.D Business Systems Design Report (BSDR)	Technologies/Operations
4.E Financial Assessment Document	Finance
4.F Product Delivery Risk Assessment and Recommendation	Team Leader
4.G Acceptance Test Plan for In-Market Test	Technologies/Operations
4.H Final Vendor Agreement	NPD
4.I Communication Plan for Test and/or Rollout	NPD
4.J Completed Gating Forms	Team Leader
4.K Process Measures Document	Team Leader

# Phase 5: In-Market Testing



Output Documents		Lead Responsibility	
	5.A Project Plan	.....	Project Manager
	5.B MIS Template for Test	.....	Finance
	5.C Financial Assessment Document	.....	Finance
	5.D Post-Test Assessment	.....	Team Leader
	5.E Completed Gating Forms	.....	Team Leader
	5.F Process Measures Document	.....	Team Leader

# Phase 6: Product Rollout & Post-Launch Assessment



Output Documents	Lead Responsibility
6.A Project Plan	Project Manager
6.B Acceptance Test Plan for Production	Technologies/Operations
6.C MIS Template for Rollout	Finance
6.D Post-Launch Assessment, Gating Forms, and Process Measures Document	Team Leader

Gate Criteria Assessment Forms

Product Name:      Securities on the Card Project

Evaluation date:      TBD

Phase Name:      Concept

Core Team Members:

Project Champion:      Norma Arnold  
Team Leader:      Adam Rothschild  
Project Manager:      TBD

Functional Area Owners:

NPD:      Nancy Rosenberg  
Virtual Bank:      Mike Bannett  
AEFA:      Jim Kerkow  
Finance:      Randa Wanis, Andrew Dermack, Miriam Mellin  
Product Marketing:      Jane Veron  
Market Research:      Rochelle Ohring  
Operations:      Rich Lopez  
Technology:      Steve Gaswirth, Amy Piper  
Legal:      Rockelle Metcalf, Bob Kraus  
Compliance:      Terri Hasson, Jim Kerkow  
Acquisition:      Peter Gorobetz  
Risk Management:      Inna Blishteyn  
Loyalty:      Dafna Sarnoff

Risk Assessment

- A fundamental driver for making decisions for the product relates to its concept and implementation risk.

Concept Risk (New to Market)	High		
	Low		
		Low Implementation Risk (New to Amex)	High

New Product Categories

Breakthroughs:

- The product comes from fundamental innovation
- The product creates a new market and is also new to the company

Platforms:

- The product allows the company to enter an established market
- The product is new to the company and implies the development of new capabilities

Line Extensions:

- The product supplements an established line of products marketed by the company, and as such increases the length of the product line

Supports:

- The new product provides improved performance or profitability over an existing product
- It entails changes in some attributes/features in order to influence perceived customer value and trigger the replacement of existing products

# Gate Criteria Assessment Forms

Question	Definition/Goal	Answer	Confidence Level H - M - L	TM Responsible	Sign Off/Date
<b>Product Potential</b> 1. What is the total market size and what portion will be gained by this product? (In terms of revenues, CV, O/S, etc.)	Total market size and market share goal for Amex from this product			NPD Finance Risk Market Research	
2. By how much can this market grow?	Target market growth based on competitive, demographic and/or psychographic trends			Product Mktg.	
3. What is the appeal of the product to the customer?	Extent of product's appeal as measured by customer research			Mkt. Research	
4 What is the product's projected profitability?	Financial goals as measured by NPV and ROE/ROA			Finance	

# Gate Criteria Assessment Forms

Question	Definition/Goal	Answer	Confidence Level	TM Responsible	Sign Off/Date
<b>Product Position</b>			H - M - L		
5. Does the product support the brand?	Product directly helps to protect or extend the brand.			Product Marketing	
6. Is the product aligned with the BU strategy?	Product launch is based on strategy in SQP, BUR or strategy statement.			Product Marketing	
7. Is the product idea aligned with the Tech. & Ops. Business Strategies?	Complies with Technology's and Operation's strategies.			Ops. Tech.	
8. How would partners (FSI's, Travel Agencies, SEs) react to launch of this product?	Would or would not adversely affect partners.			NPD Virtual Bank AEFA	
9. Will this product give Amex a competitive edge in the marketplace?	Competitor offers already exist or competitors could match our offer in time.			Product Marketing Virtual Bank AEFA	

*11 Marketing Files -  
 prospectus used  
 advertising  
 24 flow of D reg. shipped  
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## Gate Criteria Assessment Forms

Question	Definition/Goal	Answer	Confidence Level	TM Responsible	Sign Off/Date
<b>Ability to Manufacture</b>			H - M - L		
10. What are the estimated costs of development and of managing the product on an ongoing basis? (including systems, ops., mktg., and HR)	All costs by phase of development and for launch and ongoing management ; key cost drivers and extent to which costs can be applied elsewhere.	<b>Test Costs:</b> - Systems: - Ops: - Marketing: Total:  <b>Launch Costs:</b> - Systems: - Ops: - Marketing: Total:		Finance	
11. What is the estimated cycle time to rollout (by phase)?	Total elapsed time to rollout; key drivers of cycle time			NPD Virtual Bank	
12. What is Amex's capability for manufacturing this product?	Systems functionality is already in place or new functionality needs to be built/outsourced.			Tech.	

**Gate Criteria Assessment Forms**

<b>Question</b>	<b>Definition/Goal</b>	<b>Answer</b>	<b>Confidence Level</b>	<b>TM Responsible</b>	<b>Sign Off/Date</b>
<b>Ability to Manage</b>			H - M - L		
13. Do we have the capability to market and sell the product?	Distribution channels in place or new ones required. Assess availability of names/ability to accurately target.			Acquisition Virtual Bank AEFA	
14. Do we have the capability to operate and service the product?	Have the capability but no experience or do not have the capability.			Ops.	
15. Is the product legally viable?	Product compliance with statutory and regulatory restrictions.			Legal Compliance	

## Core Team Roles & Responsibilities

### Role Definitions:

- Product Champion
- ~ Oversees execution of project
  - ~ Accountable for overall project results
  - ~ Ensures appropriate team resources
  - ~ Attend gating meetings and sign-off on decision
- Team Leader
- ~ the process owner
  - ~ responsible for overall team management
  - ~ primary sponsor contact
- Project Manager
- ~ responsible for planning the delivery of the project
  - ~ reports to team leader
  - ~ oversees team communication and work flow
  - ~ manages project plan
  - ~ maintains master documents of costs and cycle times
  - ~ ensures that deliverables are produced to the established standards
- Functional Area Owner
- ~ represents functional area in policy-setting and decision making
  - ~ ensures that members of his/her functional area are updated re: project status
  - ~ ensures delivery of functional area deliverables
  - ~ develops and maintains the functional area project plan

## Core Team "Rules of the Road"

### Meetings:

- ~ All core team members attend all core team meetings
- ~ Team meetings will take place on a weekly basis (Time & Date to be agreed to by team). We will rotate responsibilities for meeting facilitation, scribe and timekeeper
- ~ If a core team member is unable to attend and participate at a meeting, he/she is responsible for empowering a replacement to attend and represent the functional area
- ~ Each team member is responsible for:
  - providing the Project Manager with an updated functional area project plan on weekly basis
  - leading the discussion of the functional area project plan at each weekly meeting
  - ensuring the completion of all activities related to your respective functional area by agreed upon dates
- ~ All ideas are important. We will allow each team member to speak without being interrupted. We will listen with an open mind to new ideas
- ~ We will be creative in our thinking
- ~ We will be constructive in resolving issues or conflict

### Communication:

- ~ When issues arise, team members will immediately notify the Team Leader. The Team Leader will then disseminate information to other team members

**"Securities on the Card" Project  
Concept Phase Kickoff Meeting**

**Agenda**

- |   |               |
|---|---------------|
| (1) Introductions                             | 9:00-9:10am   |
| (2) Securities on the Card Overview/Rationale | 9:10-9:40am   |
| (3) NPD Process                               | 9:40-10:00am  |
| - process overview                            |               |
| - gating forms                                |               |
| - team members                                |               |
| - roles and responsibilities                  |               |
| - "Rules of the Road"                         |               |
| (4) Mission Statement / Product Goals         | 10:00-10:20am |
| (5) Administration                            | 10:20-10:25am |
| - set weekly meeting                          |               |
| - schedule gating meeting                     |               |
| (6) Meeting Input / Feedback                  | 10:25-10:30am |

# **EXHIBIT 9**

# memorandum

May 1, 1996

TO: Adam Rothschild

CC: Colleen Curran  
Terry Hasson  
Jim Kerkow  
Robert Kraus  
Heidi Walters

FROM: Rockell Metcalf *RCM/pc*

RE: Purchasing Securities on The Card - The Securities Issues

## I. INTRODUCTION

This memorandum summarizes the primary securities issues in connection with offering American Express Cardmembers the ability to purchase securities through payments of their American Express Card bills. Robert Kraus is addressing consumer credit and banking issues in a separate memorandum.

The "Securities on The Card" initiative raises five major issues under the federal securities laws:

- The Collection of Moneys
- Advertising
- Extension of Credit
- Membership Miles
- Prospectus Disclosure Requirements

Each of these issues is discussed below in turn.

## II. THE COLLECTION OF MONEYS

TPS must design a remittance process in a way that it will not be deemed to have "received" money from mutual fund customers.

In a series of SEC no-action letters, the Securities and Exchange Commission has held that an unregulated entity which receives funds from mutual fund customers will be required to register as a broker-dealer. Even where companies have received funds from mutual fund customers and then remitted such amounts to a registered broker-dealer for processing, the SEC has held that the company's activities would require it to register as a broker-dealer. The SEC believes it is in

the best interest of the investing public to subject any entity which is "dabbling" or engaged in "the securities business" to its regulatory regime. Since the "Collection of Moneys" issue will be our greatest obstacle, we offer the following options as ways TRS may avoid triggering broker-dealer registration requirements.

### **Options**

- Design a process flow which channels fund money out of the hands of TRS and into the hands of American Express Service Corporation ("AESC") within 24 hours. Argue to the NASD that fund money is "technically" not being "received" by TRS since it is immediately remitted to AESC, and that broker-dealer registration requirements are therefore unwarranted.
- Turn the mail room at a TRS operations center into an AESC site; explain to the NASD and state securities commissioners that mail room employees of TRS are also treated and supervised as AESC employees; and contend that fund money coming into the TRS operations center is actually being collected by AESC not TRS. AESC credits back to TRS the amount paid in respect of regular American Express Card charges.
- Turn a wing at the TRS operations center into an AESC site. Code return envelopes so that only payments from Cardmembers participating in "Securities on The Card" program are directed to the AESC site at the operations center. AESC credits back to TRS the amount paid in respect of regular American Express Card charges.

### **III. JOINT "SECURITIES ON THE CARD" / CARD ADVERTISING**

Any communication about the "Securities on The Card" program will trigger the SEC advertising rules and the NASD Rules of Fair Practice with all of their disclosure and filing requirements. In addition, the section about the "Securities on The Card" program ("advertising rule material") must be segregated from any generic advertisement about the American Express Card ("non-rule material").

### **IV. PROMINENCE OF THE "TRS" OR "AMERICAN EXPRESS" NAME IN ADVERTISEMENTS**

Use of the TRS or American Express name in ads will require more creativity than in the previous ads for American Express Financial Direct ("AEFD"). In AEFD ads, AEFD is a non-entity and simply a generic name for the offering broker-dealer, AESC. However, ads promoting the "Securities on The Card" program must be crafted in a way that consumers are clear that AESC is offering the securities, and that TRS is offering the Card or the ability to charge securities on the Card — not the actual securities. We will likely have to work with the NASD on the issue of whether the prominence of the TRS/American Express logo confuses consumers on which entity is offering which product.



May 1, 1996

Re: Purchasing Securities on The Card - The Securities Issues

Page 3

## **V. EXTENSION OF CREDIT**

Due to regulations of the Federal Reserve System, neither TRS nor AESC may extend credit in an amount that exceeds 50% of the value of the mutual fund shares to be acquired. If TRS or AESC invested its own assets on behalf of Cardmembers in advance of receipt of payments by Cardmembers, this credit regulation would be violated. As a result, AESC must receive fund money prior to the purchase of mutual fund shares.

## **VI. MEMBERSHIP MILES**

Membership Miles may be offered as a purchase incentive, provided that shareholders within the same class are treated equally. Generally, mutual funds may not discriminate among similarly situated shareholders. In other words, one shareholder may not get a better deal than another shareholder in the same class; rather, all shareholders must pay the same price which is disclosed in the fund's prospectus. For example, AESC must avoid a situation where some shareholders purchase shares with cash and receive only mutual funds, while other shareholders purchase shares with the Card and receive shares plus a "reward" of Membership Miles.

AESC may avoid this type of unlawful discrimination by creating a new class of shares for persons purchasing securities on the Card, or by making every shareholder within a particular fund eligible for Membership Miles. We will also need to explore whether there are tax implications of offering Membership Miles for mutual funds purchased on the Card.

## **VII. PROSPECTUS DISCLOSURE REQUIREMENTS**

AESC must meet prospectus disclosure requirements related to the "Securities on The Card" program. Specifically, AESC would be required to disclose the ability to purchase mutual funds on the Card as well as the availability of Membership Miles. This disclosure may require Fund Board approval.

We look forward to working with you to develop an effective "Securities on The Card" program. If you have any questions, please do not hesitate to contact me at 612-671-1583.

RCM:pc

\\rcm\96\32

# **EXHIBIT 10**



**PRIVILEGED & CONFIDENTIAL  
COMMUNICATION FROM COUNSEL**

## Memorandum

Date: May 1, 1996

City: New York

Office: General Counsel

Subject: Charging Securities on the Card - Consumer Credit and Banking Issues

To: Adam Rothschild

This memorandum summarizes the chief consumer credit and banking issues that arise from the proposal to allow the purchase of securities (stocks, bonds, mutual funds, etc.) to be charged to an American Express charge or credit card account. Issues involving securities law (including margin credit, advertising, remittance processing, and other broker/dealer considerations) will be addressed in a separate memorandum from Rockell Metcalf.

Goods and Services Disputes - Section 226.12(c) of the Federal Reserve's Regulation Z permits a cardholder to assert all claims (other than tort claims) and defenses arising out of credit card transactions against the issuer of the card, and authorizes the cardholder to withhold payment up to the amount of the charge relating to the dispute. In order to assert this right, the cardholder must first attempt to resolve the dispute directly with the merchant (this requirement is satisfied by making a perfunctory inquiry with the merchant), the amount involved must exceed \$50, and the transaction must have taken place in the same state or within 100 miles of the cardholder's home address; however, these last two limitations do not apply to mail orders or transactions where the merchant is an affiliate of the card issuer.<sup>1</sup>

Therefore, if a claim or defense arises out of a purchase of securities on a card account, such as a consumer's claim that he was misled or ill-advised into engaging in a transaction, the consumer could withhold payment on his/her card account.

Goods and service disputes generally result in informal mediation by American Express between the cardmember and the merchant, and significant sums are written off each

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<sup>1</sup>A mutual fund advised by an AEFA affiliate would qualify as an affiliate of an American Express card issuer; shares of stock or bonds brokered by an AEFA broker/dealer may also qualify for the exception to the \$50/100 mile rule, although this is not certain.

year as part of our obligations under this provision. AEFA's experience in dealing with dissatisfied customers would likely be lower than that which would be experienced in the card context, since card holders are conditioned to take advantage of their broad rights under the consumer credit rules, and since the remedy of withholding funds relating to disputes is only available in the credit and charge card context.

Billing Disputes. In addition to goods and services disputes, Regulation Z provides a mechanism for resolving billing errors, which are defined to include various forms of miscalculations on billing statements. Such disputes must be resolved within two complete billing cycles of their being lodged by the customer. There is often a period of time, within the two cycle limit, during which such disputes are investigated. The proposal raises the possibility that the market price of securities purchased on the card will vary during the billing error investigation, resulting in a loss to American Express if the customer is to be made whole.

Sections 23A and 23B of the Federal Reserve Act. These sections of the law restrict quantitatively and qualitatively the transactions that a bank may engage in with an affiliate.<sup>2</sup> Among other restrictions, the law limits the amount of "covered transactions" outstanding at any time to 10% of the bank's capital with respect to any single affiliate, and 20% with respect to all affiliates in the aggregate. "Covered transactions" include an extension of credit (even if payable in full and even if no finance charges accrue) to a third party secured by securities issued or underwritten by an affiliate, including shares of a mutual fund advised by an affiliate.

Therefore, to the extent that AEFA mutual fund shares serve as collateral for any charges on the card accounts (if issued by the Bank), either as part of the structure of a secured card or *de facto* as a result of our asserting a claim on such shares by right of setoff or in the event a transaction fails, the receivables arising out of such transactions will have to be sold off the Bank's balance sheet, together with other such receivables. This mechanism has been a successful way of dealing with our 23A exposure to date, but it does not have an infinite capacity. Careful tracking of this process must be established, with the attendant systems and operational issues this may cause.

Section 23B also requires that all relationships between a bank and its affiliates be conducted on an arm's-length basis, and not to the detriment of the Bank. If, due to securities law requirements, we develop the capability to clear remittances rapidly, we should assure that doing so would not result in any greater exposure for our Bank card issuer. This may mean that remittances directed to Centurion Bank are cleared as quickly as those directed for investment in securities.

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<sup>2</sup>The Optima Card is currently issued by American Express Centurion Bank, while the charge card (all versions) is issued by American Express Travel Related Services Company, Inc., a non-bank. There is a possibility that the charge card will be issued by AECB in the future. Therefore, the restrictions imposed on banks are relevant to this discussion.

Operations. American Express has a specific remittance processing hierarchy in which securities would have to fit. Although this is currently done for Privileged Assets, it is not available on Optima systems. We would have to anticipate handling disputes where payments may have been misapplied. Aside from the remittance processing issues impacted by the securities laws and addressed separately, operations will have to assure that customer service operators do not engage in impermissible securities activities without obtaining the proper licenses. This may impact the utility processing objectives and force calls to be dial-transferred to the appropriately qualified personnel.

Regulatory Relations. Regulatory relations are increasingly important for the successful fulfillment of our business objectives. Over the years, management has worked diligently at building up a relationship of candor and trust with the banking regulators, particularly those supervising our Utah-based institution. The intermingling of American Express' card and securities businesses, although legal, is certain to attract at least some attention from the bank regulators. It would be prudent to involve Bank management in the process of developing this capability, and for management to apprise the regulators, at the appropriate time, of our intentions.

Use of Optima Card. Assuming that purchases of securities will not be able to be revolved, we will have to decide whether to allow the Optima Card to be used for this purpose at all. Although it would be possible to allow the Optima Card to be used for such purchases and require that such amounts be paid in full, that would require that our system accomodate the special nature of these purchases, separate from normal SE charges. There are also numerous risks inherent in offering credit, even 30-day credit, for purchases of this type.

\* \* \* \* \*

Other issues may surface as the proposal takes shape. Please do not hesitate to call me if you have any questions.



Robert D. Kraus  
Group Counsel

cc: R. Metcalf  
J. Kerkow  
T. Hasson  
T. Heine  
A. Kenyon  
J. Leggett

# **EXHIBIT 11**

From: NROSEN --MAILHUB1

Date and time 96/05/03 11:10:00 ✓

From: Nancy Rosenberg at MailHub1 1996/05/03 11:10  
To: Jim Kerkow at IDSVM1, Rockell Metcalf at IDSVM1  
To: Adam Rothschild @ AMEX at NYKNOT01  
To: Andrea Mann @ AMEX at NYKNOT01, David Smith at NYKNOT01  
To: Gregory T Phalin @ AMEX at NYKNOT01, Inna Blishteyn at NYKNOT01  
To: Janna Lewis @ AMEX at NYKNOT01, Jim Jacobs at NYKNOT01  
To: Laura J. Morrow @ AMEX at NYKNOT01  
To: Mike Bennett @ AMEX at NYKNOT01, Miriam Mellin at NYKNOT01  
To: Randa Wanis @ AMEX at NYKNOT01, Rich Lopez at NYKNOT01  
To: Robert Kraus @ AMEX at NYKNOT01  
Subject: Securities on the Card Meeting Minutes

## ----- Message Contents -----

What follows is a summary of today's Securities on the Card Meeting:

## Key Issues:

1) Adding an SE number to the Privileged Assets systems to route funds from the A/R system to a new vendor (e.g., AEFA) would require 2000 programming hours. Today, there are two SE numbers on the Privileged Assets system -one is being used infrequently. We need to determine if

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Assets system -one is being used infrequently. We need to determine if this SE number can be used for our purposes

2) In the Privileged Assets flow, the date for the receipt of funds being posted systematically is the date the check is passed to the vendor, not the date the funds are received. The vendor is then manually backdating the posting date to equal the date the funds were received

3) Currently, if a P/A Cardmember sends in a payment amount less than the charge card payment due + the monthly investment contribution, a TPNS script (a workaround solution) is crediting A/R for the monthly investment contribution amount to avoid dunning the CM. We need to understand if this TPNS script could be used for our purposes

4) AEIS systems are essential - They will need to (1) notify TRS to charge CM for investment contribution on a monthly basis, and (2) allocate the funds received into the CM's designated investment vehicles - Technologies needs to work with the AEIS Technologies group (Rick Sykes) to determine how to build this functionality

5) Need to determine timing from receipt of funds in TRS to deposit into P/A account

6) Alternative solutions discussed include:

- Can we accept funds into TRS and then park them in a bank account until the funds clear before transferring them to AEFA? This would

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until the funds clear before transferring them to AEFA? This would eliminate the 24 hour issue, but could significantly increase the amount of time from when funds are received in TRS to when securities are actually purchased

- Can we use checkless remit (i.e., transfer funds from CM's existing bank acct to AEFA)?
- Can funds be sent directly from CM to AEFA?

Next Steps:

1) Technologies will investigate the following - G. Phalin:

- \* Determine if existing SE number can be used for our purposes
- \* Determine if TPNS script could support this initiative
- \* Technologies needs to work with the AEIS Technologies group (Rick Sykes) to determine how to build back-end functionality
- \* Determine timing from receipt of funds in TRS to deposit into P/A account

2) Operations to assess "doability" within 24-hour timeframe - R. Lopez

3) Determine target market/market sizing - M. Bannett, J. Kerkow, A. Mann, N. Rosenberg, L. Morrow

4) What % of Privilege Assets' clientbase are currently making payments through the Card - L. Morrow

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through the Card - L. Morrow

If I have missed or misrepresented anything, please let me know.

Thanks,

Nancy

E N D O F N O T E

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# **EXHIBIT 12**

## VIEW THE NOTE

E01

From: RKRAUS --NYKGC001

Date and time

96/05/28 11:42:00

From: Robert Kraus at NYKGC001 1996/05/28 11:42

To: Rockell Metcalf at IDSVM1

Subject: AXP Stock on the Card

## ----- Message Contents -----

By coincidence, the Secretary's office is looking at the possibility of allowing participants in the Company's dividend reinvestment plan to purchase additional shares of AXP stock by charging it to the card.

Steve has worked with the General Counsel of Chemical/Mellon Shareholder Services, our transfer agent (he's Steve Dolmatch, an alum of the corporate GCO), who has identified a number of operational issues similar to ours (such as handling short remittances, etc.), but it appears that the fundamental question we encountered under the 40 Act (the need to process remittances within 24 hours) does NOT exist in this context.

I thought this information may be of interest to you. I

don't know what the current status of the Securities on the

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VIEW THE NOTE

E01

don't know what the current status of the Securities on the Card project is, but was interested to learn of this development.

Regards. ----RDK

E N D O F N O T E

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# **EXHIBIT 13**

## VIEW THE NOTE

E01

From: RKRAUS --NYKGC001

Date and time

96/05/28 12:25:00

From: Robert Kraus at NYKGC001 1996/05/28 12:25

To: Rockell Metcalf at IDSVM1

Subject: Re: AXP Stock on the Card

----- Message Contents -----

To: RKRAUS --NYKGC001

\*\*\* Reply to note of 96/05/28 11:42

From: Rockell Metcalf

Subject: AXP Stock on the Card

Thanks for sharing the information! Funny that you would write, because I was planning on sharing with you today as well. This morning I had a conference call with Norma Arnold and company of AEFD. We are considering a rewards program that would connect MR points to the purchase of a security. AEFD may be approaching Delta for Sky Mile points for Non-MR Cardmembers and Non-CMs. Weren't you involved in the negotiations for Delta Sky Miles? Any advice I could pass on to AEFD business partners. If you'd like more information or would like to discuss, let me know.

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Profs = RockellM, T27/52, x1583

Jeff Martel handled the bulk of the Delta negotiations. I was involved from the receivables financing perspective, and counseled the implementation effort. You should contact him for negotiating tips. Thanks. ---RDK

E N D O F N O T E

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# **EXHIBIT 14**

MEMORANDUM

May 29, 1996

TO: Colleen Curran  
Gary Domann  
Laura Moret

CC: Ed Wistrand

FROM: ~~Feres~~ Feres Rasmussen

RE: Amendments to Reg. T and proposed amendments to Regs. T, G  
and U.

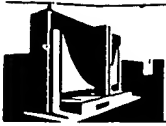
I received the Fed's amendments to Reg. T today. These amendments are effective on July 1, 1996. Also enclosed are proposed amendments to expand the number of equity securities eligible for loan value under Reg T. Comments are due on July 1, 1996.

The Fed has made substantial amendments to Reg. T. Colleen, the Fed. has essentially eliminated the restrictions on the ability of broker/dealers to arrange for credit. This should be of particular interest to you given the Financial Direct channel.

Laura and Gary, the rest of the amendments involve reducing restrictions on transactions involving foreign persons, foreign securities and foreign currency as well as expanding the type and number of securities that may be bought on margin.

These are the most significant amendments to Reg. T since 1975.

Rockwell -  
will this  
give us  
any mileage  
re payment  
on the card  
- [signature]



# Regulations/Operations

Federal Reserve Bank of Minneapolis

250 Marquette Avenue  
Minneapolis, MN 55401-2171

Subject: **Final Amendments to Regulation T**

Date: May 20, 1996

*Handwritten note:*  
Held for review  
by Fed. Reserve  
+ Comptroller

To All Banks, Multi-Bank Holding  
Companies and Other Concerned in  
the Ninth Federal Reserve District:

RE: Docket No. R-0772

## Summary:

The Federal Reserve Board has announced a final rule to Regulation T to significantly reduce regulatory burden.

The final rule is generally effective July 1, 1996, though certain provisions relating to options transactions become effective June 1, 1997.

The final rule constitutes some of the most significant reductions of regulatory burden on broker-dealers since 1934 by:

- eliminating restrictions on the ability of broker-dealers to arrange for credit;
- increasing the type and number of domestic and foreign securities that may be bought on margin and increasing the loan value of some securities that are already marginable;
- deleting Board rules regarding options transactions in favor of the rules of the options exchanges; and,
- reducing restrictions on transactions involving foreign persons, foreign securities, and foreign currency.

Additionally, technical changes have been made to provide clarification, update references, or restore language inadvertently deleted.

The *Federal Register* notice is attached.

## Who to Call:

For questions on the above:

Ron J. Feldman, Financial Specialist, Banking Supervision (612) 340-7702

In-Watch Phone Numbers for those calling from:

Minnesota (612) 340-7702  
Montana (800) 332-3402  
North Dakota, South Dakota, Nebraska (612) 340-7702

Federal Reserve Bank of Minneapolis (612) 340-7702  
Helena (Montana) In-Watch 800-332-3402

## FEDERAL RESERVE SYSTEM

## 12 CFR Part 220

[Regulation T; Docket No. R-0772]

FIN 7100-AB28

## Securities Credit Transactions; Review of Regulation T, "Credit by Brokers and Dealers"

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

**SUMMARY:** The Board is adopting amendments to Regulation T, the regulation that covers extensions of credit by and to broker and dealers. These amendments reflect consideration of the comments submitted in response to the proposed rule issued by the Board for public comment on June 29, 1995.

Major amendments include eliminating restrictions on the ability of broker-dealers to arrange for credit; increasing the type and number of domestic and foreign securities that may be bought on margin and increasing the loan value of some securities that are already marginable; deleting Board rules regarding options transactions in favor of the rules of the options exchanges; and reducing restrictions on transactions involving foreign persons, foreign securities, and foreign currency. In addition, technical changes are being adopted to provide clarification, update references, or restore language inadvertently deleted. The Board is also soliciting comments on the possibility of additional Regulation T amendments in a separate document published elsewhere in today's Federal Register.

EFFECTIVE DATE: July 1, 1996.

**FOR FURTHER INFORMATION CONTACT:** Scott Holz, Senior Attorney, or Angela Desmond, Senior Counsel, Division of Banking Supervision and Regulation (202) 452-2781; for the hearing impaired only, Telecommunications Device for the Deaf (TDD), Dorothea Thompson (202) 452-3544.

**SUPPLEMENTARY INFORMATION:** In 1992, the Board issued an Advance Notice of Proposed Rulemaking and Request for Comment to aid in its periodic review of Regulation T.<sup>1</sup> In 1994, the Board proposed and adopted amendments exempting transactions involving government securities and shortening the time period within which customers must deposit margin requirements or make payment for securities in light of the industry's move to a three-day

settlement period.<sup>2</sup> In June 1995, the Board published proposed amendments covering additional areas of Regulation T.<sup>3</sup> Forty-six comment letters were received in response to the 1995 proposal. The review of Regulation T predates but is now encompassed within the Board's regulatory review under section 303 of the Riegle Community Redevelopment and Regulatory Improvement Act of 1994.

The Board is now adopting a final rule which covers four major areas: arranging for credit, loan value of securities, options transactions, and international transactions.

In the arranging area, the Board is eliminating all restrictions on the ability of broker-dealers to arrange for credit that does not otherwise violate the lending provisions of the Board's margin regulations.

Amendments regarding the loan value of securities include changing the loan value of money market and exempted securities mutual funds from 50 percent to "good faith" loan value. The Board is adopting additional, alternate criteria for unlisted debt securities so that any debt security with an investment grade rating will be entitled to "good faith" loan value. The Board is also adopting an additional method for foreign stocks to qualify for margin treatment that will result in an increase in the number of foreign margin stocks from approximately 700 to approximately 1800 stocks. The Board is extending loan value to convertible bonds that do not meet the existing margin criteria if the underlying security is already marginable. Finally, the Board is extending loan value to exchange-traded options, which will be entitled to the loan value deemed appropriate by the exchange that trades the option, subject to the approval of the Securities and Exchange Commission (SEC).

In addition to giving loan value to exchange-traded options, other amendments in the options area will increase Regulation T's reliance on the margin rules of the exchange where the option is traded for customer and specialist transactions. This will allow increased flexibility in recognizing the offsetting nature of certain transactions and assets, such as financial futures. The Board is retaining the current provisions until June 1, 1997 in response to requests from options exchanges for extra time to develop

exchange rules and have them approved by the SEC.

The Board is reducing Regulation T restrictions on international transactions involving the borrowing and lending of foreign securities that are not publicly traded in the United States and giving broker-dealers greater flexibility to accept foreign currencies, compute margin requirements using foreign currencies, and deal with foreign broker-dealers on the same basis as domestic broker-dealers. These changes are discussed more fully below. The amendments are discussed in the order they appear in the regulation.

## Section 220.2 Definitions

The following new definitions or amended definitions are being adopted as proposed: *cash equivalent*, *exempted securities mutual fund*, *foreign person*, *in the money*, *margin security*, *money market mutual fund*, *non-U.S. traded foreign security*, and *OTC margin stock*. As proposed, the Board will delete the definition of *in or at the money*, but this will be delayed until June 1, 1997, when the other option-specific rules of Regulation T are deleted.<sup>4</sup> The effect of the definitions is described below under the section in which the defined term is used. Definitional changes that have the effect of increasing the types and number of securities that are marginable are discussed below under section 220.18, Supplement: *Margin requirements*.

The following definitions are being amended based on comments: *covered option transaction*, *escrow agreement*, *OTC margin bond*, *permitted offset position*, *short call or short put*, and *underlying security*. The modifications are technical in nature, with the exception of those discussed in the following two paragraphs.

The Board proposed to add the word "sold" to the definition of *short call or short put* and the list of permissible transactions in the cash account to mimic rules of the self-regulatory organizations (SROs). The word is not being added in light of comments pointing out that the Board's proposal would cover transactions that are not covered by SRO rules, which was not the Board's intent.

<sup>4</sup> See also the definition of *permitted offset position* in section 220.2, section 220.4(b)(8), section 220.12(b)(6), and section 220.18(f). Several options exchanges requested a delay in effectiveness of Regulation T provisions which replace Board-specified options rules with reference to exchange rules. In order to allow the exchanges to develop rules in these areas and have them approved by the SEC, the Board is delaying the effectiveness of the new options provisions in Regulation T until June 1, 1997.

<sup>2</sup> The proposed amendments were published at 59 FR 33923 (July 1, 1994) and the final rule was published at 59 FR 53565 (October 25, 1994).

<sup>3</sup> 60 FR 33763 (June 29, 1995). The comment period was subsequently extended at the request of commenters (60 FR 43726, August 23, 1995).

<sup>1</sup> 57 FR 37109 (August 18, 1992).

The definition of *underlying security* is being changed to *underlying asset* to account for the fact that not every asset underlying a securities option is a security. A conforming change has also been made to the definition of *in the money*. The definition is also being changed from the proposal so that customers and specialists may hold less than all of the securities in an index as cover for a short option position if SEC-approved rules of the SRO where the option is traded allow partial baskets. The language that was proposed required that all securities that comprise an index be held in the same proportion as the index.

#### Section 220.3 General Provisions

The Board is amending section 220.3(e)(4), which permits what the industry refers to as "cashless exercise" of employee stock options, to cover additional types of securities received by customers pursuant to an employee benefit plan and to conform with SEC rules that determine who is covered under these plans and therefore who may take advantage of the "cashless exercise" procedure. The Board is modifying the language that was proposed to accommodate employee stock award plans.

The Board is also adding a new paragraph to the general provisions in section 220.3 to make clear that freely convertible currency can be accepted by creditors and treated at its U.S. dollar equivalent on a marked-to-market basis for all purposes under Regulation T. Marking to market should minimize currency risk.

#### Section 220.4 Margin Account

Consistent with the amendment to the general provisions in section 220.3 of Regulation T allowing freely convertible foreign currency to be accepted for all purposes under Regulation T, the Board is amending Regulation T to enhance the ability of broker-dealers to extend credit denominated in a foreign currency by eliminating the restriction in section 220.4(c) that prevents an increase in one foreign currency subaccount from offsetting a decrease in another foreign currency subaccount. The Board is also simplifying the language that was proposed for section 220.4(b)(8) to allow broker-dealers to extend credit in any freely convertible currency, whether or not a security denominated in that currency is (or was) held in the account.

As proposed, the Board is completing the process of deferring to SRO rules for options transactions by deleting specific provisions governing cover or positions in lieu of margin found in section

220.5(c) in favor of SRO rules. This change will become effective on June 1, 1997. The margin requirement for a customer who writes an over-the-counter (OTC) option that is purchased by its broker-dealer will be determined by the rules of the broker-dealer's examining authority.

As proposed, the margin account exceptions and special provisions in section 220.5 have been incorporated into section 220.4 so that each Regulation T account is described in a single section. The special memorandum account and the government securities account are being renumbered as section 220.5 and 220.6 respectively. No substantive change is intended by this renumbering.

#### Section 220.8 Cash Account

The Board is amending the cash account, as proposed, to recognize industry practice by specifically allowing the purchase of nonsecurities on a cash basis in the cash account. Because this change includes foreign currencies, foreign exchange transactions can be effected on a cash basis in the account.

The Board is adding money market mutual funds to the definition of *cash equivalent* as proposed to allow these mutual fund shares to be used to cover puts in the cash account. In response to commenters, the Board has added language to section 220.8(a)(4) to make clear that cash equivalents covering options transactions may be held in the account via an escrow agreement.

The specific option transactions formerly permitted in the cash account pursuant to section 220.8(a)(3) have been incorporated into a definition for *covered option transactions* along with new authority, effective June 1, 1997, for the SROs to permit additional transactions with finite risk in this account. The proposed language has been modified to permit greater flexibility for the SROs. This flexibility includes covering (1) transactions in which a customer's risk is not a fixed dollar amount but is effectively limited to the value of the assets securing it, (2) transactions in which early exercise of any aspect of the transaction results in contemporaneous exercise of all aspects, and (3) OTC options transactions. SROs may designate covered transactions by category if they choose to do so.

The Board is amending section 220.8(b)(1)(ii), the cash account provision covering the purchase of foreign securities with extended settlement periods, as proposed, so that a broker-dealer will not be required to sell a customer's securities for failure to make payment until one day beyond the

foreign settlement date. Currently, a broker-dealer must receive its customer's payment by settlement date. The extra day will allow the broker-dealer to verify that its failure to receive the customer's payment is not due to time zone differences, error, or other exceptional circumstances.

#### Section 220.11 Broker-Dealer Credit Account

Two substantive changes proposed by the Board are being made to section 220.11(a), *Permissible transactions*. First, the Board is amending section 220.11(a) to permit foreign broker-dealers to use this account for delivery-versus-payment transactions with U.S. broker-dealers. Under this amendment foreign broker-dealers are referred to as "persons regulated by a foreign securities authority." Regulation T incorporates the definitions from section 3(a) of the Act, which defines a "foreign securities authority" to include entities "empowered by a foreign government to administer or enforce laws as they relate to securities matters." Several commenters stated that the Board's proposal may not encompass entities such as universal banks that are generally recognized as broker-dealers but are regulated by a banking regulator that is also responsible for securities regulation in that country. The Board believes that the phrase "person regulated by a foreign securities authority," is broad enough for purposes of Regulation T to cover universal banks.

The Board is also amending section 220.11(a) to include "prime broker" arrangements set up under SEC guidelines<sup>5</sup> in the list of permissible transactions. This will permit use of the broker-dealer credit account by executing broker-dealers so that a customer's transactions may be consolidated at the customer's prime broker.

In 1995, the Board proposed an amendment to clarify that the joint back office (JBO) arrangements established pursuant to section 220.11(a)(2), which allow participant broker-dealers to be treated as if they were self-clearing broker-dealers, require a reasonable relationship between the owners' equity interests and the amount of business transacted through the JBO. The Board's intention in 1983 in first permitting the formation of JBOs was to allow for economies of scale among registered broker-dealers, and the Board believed it was unnecessary to explicitly require a specific capital structure to ensure equitable treatment among participants.

<sup>5</sup> See, Fed. Sec. L. Rep. (CCH) ¶ 76,819.

Several commenters noted that the Board's 1995 proposal was ambiguous; others suggested that the current language could be interpreted to prevent unreasonable arrangements without the need for amendment; and several commenters, including some opposed to the Board's proposal, were in favor of involving SROs in this process. After considering the comments, the Board has decided not to incorporate its understanding into the regulation and believes it is appropriate to rely on the authority of the JBO's examining authority (SRO) to ensure the reasonableness of JBO arrangements under its supervision.

#### Section 220.12 Market Functions Account

The Board proposed two substantive amendments to this section and is adopting both of them. First, the Board is amending section 220.12(b), *Specialists*, to delete the specific "permitted offset positions" established by the Board in favor of SEC-approved rules of the SROs. Permitted offset positions are entitled to good faith margin, and allowing exchange rules to govern these transactions is consistent with the Board's intention to allow margin requirements for options transactions and margin requirements for specialists to be determined by the appropriate market, subject to SEC approval. This change will be effective June 1, 1997.

Second, the Board is revising the description of OTC marketmakers and third marketmakers to respond to questions raised about the coverage of this provision. The revision concerning third marketmakers mirrors the language in Regulation U, while the revision concerning OTC marketmakers ensures that the exempt credit available to OTC marketmakers, like the exempt credit for specialists, is in return for market-making obligations enforced by the regulatory authority for that market.

#### Section 220.13 Arranging for Loans by Others

The Board is amending section 220.13 to permit creditors to arrange for any credit transaction so long as they do not willfully arrange credit that otherwise violates the Board's margin regulations. Currently, broker-dealers cannot arrange for transactions they could not engage in themselves unless covered by one of the exceptions found in this section.

Section 7 of the Act requires broker-dealers to comply with Federal Reserve margin regulations when they "extend or maintain credit or arrange for the extension or maintenance of credit." Since 1938, Regulation T has contained

a provision addressing the "arranging" of credit by broker-dealers. This provision remained unaltered until 1975, when the Board began to adopt exceptions to the general prohibition. Although the arranging prohibition was intended to prevent a broker-dealer from circumventing Regulation T by arranging for another lender to extend credit that the broker-dealer was prevented from extending itself, the Board's regulations now cover most U.S. margin lenders directly.<sup>6</sup>

One of the most basic and frequently raised trends noted in the comments received since the Board announced its review of Regulation T is the erosion of barriers between broker-dealers and other lenders, including globalization of the securities markets and the increasing overlap in the businesses of these various lenders. Several trade associations and broker-dealers responded favorably to the Board's request for comment on applying the arranging restriction only to credit that otherwise violates the Board's margin regulations.

The Board has concluded that broker-dealers should be permitted to arrange for any credit that is not directly prohibited by a Federal Reserve margin regulation. Because a broker-dealer may not know all of the credit terms agreed to between its customer and the actual lender, the amended language prohibits a broker-dealer from willfully arranging credit that violates one of the Board's margin regulations. The ability of broker-dealers to arrange for credit in connection with new issues of securities will still be constrained by section 11(d) of the Act and the rules of the SEC issued thereunder.<sup>7</sup>

#### Section 220.16 Borrowing and Lending Securities

The Board proposed two changes for this section, and is adopting both of them. First, the Board is expanding the types of permissible collateral for securities lending transactions to include marginable foreign sovereign debt securities and any other collateral that is acceptable to the SEC when a

broker-dealer borrows securities from its customer.<sup>8</sup>

Second, the Board is adding a new subsection 220.16(b) to allow U.S. broker-dealers to lend foreign securities that are not publicly traded in the United States to a foreign person for any purpose, and against any collateral, legally permitted in the foreign country. Although several commenters stated their preference for also extending this liberalized treatment to foreign stocks that are publicly traded in the United States, other commenters, including U.S. securities exchanges, stressed the importance of equal treatment in this area for all securities that are publicly traded in the United States. The Board is confirming several clarifications in this area requested by the commenters: (1) a foreign security not listed on NASDAQ or a U.S. national securities exchange is not "U.S. traded" solely because American Depositary Receipts (ADRs) on the foreign security are traded in the United States; (2) new section 220.16(b) is not mandatory and creditors may continue to borrow and lend foreign securities under the existing rule in section 220.16(a); and (3) coverage of the term "foreign lender" is determined by the status of the beneficial owner of an account and includes a non-U.S. person with a U.S. investment adviser or other fiduciary. The Board is also amending the language that was proposed to make clear that a creditor may borrow foreign securities pursuant to section 220.16(b) for the purpose of relending them to a foreign person (or relending them to a U.S. person as long as the ultimate borrower is a foreign person).

The Board is also amending section 220.16 to address questions regarding "pre-borrowing," that is the borrowing of securities in anticipation of a short sale. Currently, securities may be borrowed for a permitted purpose when the transaction has been effected "or is in immediate prospect".<sup>9</sup> The section will now provide that a creditor who reasonably anticipates a short sale may borrow securities up to one standard settlement cycle in advance of the trade date. The standard settlement cycle is contained in SEC Rule 15c6-1<sup>10</sup> and is currently three business days.

<sup>6</sup> The SEC requirements are found in Rule 15c3-3 (17 CFR 240.15c3-3).

<sup>7</sup> See 12 CFR 220.103, a Board Interpretation reprinted in the *Federal Reserve Regulatory Service* at 5-472.

<sup>10</sup> 17 CFR 240.15c6-1.

<sup>6</sup> The Board adopted Regulation U in 1936 to cover securities credit extended by banks. In 1968 the Board adopted Regulation G to cover most other margin lenders in the United States, and in 1971 the Board adopted Regulation X to cover U.S. borrowers obtaining margin credit against U.S. securities abroad.

<sup>7</sup> Section 11(d) of the Act prohibits a broker-dealer from extending or maintaining or arranging for the extension or maintenance of credit on any newly issued security if the broker-dealer has been involved in the distribution of that security within the past thirty days. The section is aimed at preventing a broker-dealer from inducing its customer to buy on credit securities which it has undertaken to distribute to the public.

### Section 220.17 Requirements for the List of Marginable OTC Stocks and the List of Foreign Margin Stocks

The Board is adopting additional, alternative criteria for determining which foreign stocks qualify as margin equity securities. The Board has published a *List of Foreign Margin Stock* (Foreign List) since 1990, using criteria modeled on those for OTC margin stocks. In the 1995 proposal, the Board asked for comment on whether foreign stocks should also be marginable if they meet two criteria: (1) the SEC or CFTC has approved trading in the United States of options, warrants, or futures on a foreign securities index that contains the foreign stock and (2) the stock is deemed to have a "ready market" for purposes of the SEC's net capital rule.<sup>11</sup> The SEC has issued a no-action letter that effectively treats all stocks on the Financial Times/Standard & Poor's World Actuaries Indices as having a "ready market" for capital purposes, and requested comment on adopting regulatory language to this effect.<sup>12</sup>

None of the commenters opposed the Board's proposal to enlarge the number of foreign margin stocks, but many suggested modification of the proposed criteria. Some commenters asked the Board to use the SEC's capital rule's "ready market" test as a criterion for determining the margin status of foreign securities. The Board has concluded that a determination that a foreign stock has a "ready market" for purposes of the SEC's net capital rule is a more particularized determination about the collateral value of the stock than SEC or CFTC approval for trading in the United States of an index product containing the stock. The Board is therefore adopting this test as an alternate method by which stocks will be included on the Foreign List. To implement this change, stocks on the Financial Times/Standard & Poor's Actuaries World Indices will be added to the Board's Foreign List as soon as practical.

Comments were few and contradictory concerning how a new test for foreign margin stocks should be integrated with the Board's Foreign List. The Board is requesting additional comment regarding the Foreign List in the proposed rule published elsewhere today in the Federal Register.

### Section 220.18 Supplement: Margin Requirements

The Board is increasing the coverage of the definitions of *margin security* and *OTC margin bond* and is allowing loan value for exchange-traded options that

are currently denied loan value.<sup>13</sup> The Board is also changing the loan value of mutual funds whose portfolios consist of exempted securities and money market mutual funds. These mutual funds were previously subject to the margin for margin equity securities (currently 50 percent) and today's amendments will instead allow good faith loan value.

The Board is amending the definition of *margin security* to cover a debt security convertible into a margin security. This mirrors the treatment of convertible bonds in Regulations G and U, as well as Regulation T's treatment of foreign convertible bonds.

The Board is also amending the definition of *OTC margin bond* to include any nonconvertible debt security with an investment grade rating. Although commenters suggested a variety of ways to expand the categories of unlisted debt securities entitled to good faith margin as "OTC margin bonds," at a minimum there was agreement that an investment grade rating (i.e. a rating in one of the top four rating categories by a nationally recognized statistical rating organization) should be sufficient to make a debt security marginable. The Board has successfully used rating criteria for unregistered mortgage-related securities<sup>14</sup> and foreign debt securities and believes it is now appropriate to enlarge the number of qualifying ratings and extend this treatment to other debt securities.

The Board is permitting loan value for exchange-traded options, but has modified its 1995 proposal that options be given the same fifty percent loan value if listed on a national securities exchange as other exchange-traded equity securities. Commenters, including some of the options exchanges, indicated that the time value of options may make it appropriate to have higher margin requirements for options approaching expiration and expressed support for use of SRO rules in this area generally. Rather than adopting a flat 50 percent margin requirement, the Board is incorporating into Regulation T the margin

requirements established by the exchange that trades the option. This change will also respond to commenters seeking confirmation that the Board intends to allow loan value for options on non-equity securities. To ensure comparability with exchange-traded warrants on securities indexes and warrants on foreign currency, these products will also be subjected to exchange maintenance margin rules in lieu of specific Regulation T requirements. Margin requirements for short OTC options will continue to be subject to the rules of the examining authority of the broker-dealer involved.

### Board Interpretations

The Board has begun to review its interpretations of Regulation T, and is deleting eleven interpretations as a first step. These interpretations have either been incorporated directly into the regulation or have become moot due to subsequent amendments. The Board will continue its review to cover the remaining interpretations.

### Regulatory Flexibility Act

The amendments being adopted are intended to simplify regulatory requirements and eliminate restrictions currently imposed on broker-dealers and their customers. The Board is also increasing reliance on the rules of the SEC and SROs so that Regulation T will reflect market developments that are subsequently approved by regulators with primary responsibility for the securities markets. The Board believes that these benefits will be shared by all broker-dealers and the amendments will not have a substantial adverse effect on a significant number of small broker-dealers.

### Paperwork Reduction Act

No collections of information pursuant to section 3504(h) of the Paperwork Reduction Act (44 U.S.C. 3501 *et seq.*) are contained in this rule.

### List of Subjects in 12 CFR Part 220

Banks, banking, Brokers, Credit, Federal Reserve System, Margin, Margin requirements, Reporting and recordkeeping requirements, Securities.

For the reasons set out in the preamble, 12 CFR Part 220 is amended as follows:

### PART 220—CREDIT BY BROKERS AND DEALERS (REGULATION T)

1. The authority citation for Part 220 continues to read as follows:

Authority: 15 U.S.C. 78c, 78g, 78h, 78q, and 78w.

<sup>11</sup> See SEC Rule 15c3-1 (17 CFR 240.15c3-1).

<sup>12</sup> 58 FR 44310, August 20, 1993.

<sup>13</sup> Although most customers cannot purchase exchange-traded options on credit, specialists in these options and the underlying securities have been able to obtain good faith credit on options for some time.

<sup>14</sup> The Board first used a rating requirement when it fulfilled Congress' mandate under the Secondary Mortgage Market Enhancement Act of 1984 by making a "mortgage-related security" marginable. The Congressional definition of "mortgage-related security" included a requirement that the security be rated in one of the top two rating categories by a nationally recognized statistical rating organization.



2. Sections 220.1 through 220.18 are revised to read as follows:

**§ 220.1 Authority, purpose, and scope.**

(a) *Authority and purpose.* Regulation T (this part) is issued by the Board of Governors of the Federal Reserve System (the Board) pursuant to the Securities Exchange Act of 1934 (the Act) (15 U.S.C. 78a *et seq.*). Its principal purpose is to regulate extensions of credit by and to brokers and dealers; it also covers related transactions within the Board's authority under the Act. It imposes, among other obligations, initial margin requirements and payment rules on securities transactions.

(b) *Scope.* (1) This part provides a margin account and eight special purpose accounts in which to record all financial relations between a customer and a creditor. Any transaction not specifically permitted in a special account shall be recorded in a margin account.

(2) This part does not preclude any exchange, national securities association, or creditor from imposing additional requirements or taking action for its own protection.

(3) This part does not apply to transactions between a customer and a broker or dealer registered only under section 15C of the Act.

**§ 220.2 Definitions.**

The terms used in this part have the meanings given them in section 3(a) of the Act or as defined in this section.

*Cash equivalent* means securities issued or guaranteed by the United States or its agencies, negotiable bank certificates of deposit, bankers acceptances issued by banking institutions in the United States and payable in the United States, or money market mutual funds.

*Covered option transaction* means:

(1) In the case of a short call, the underlying asset (or a security immediately convertible into the underlying asset, without the payment of money) is held in or purchased for the account on the same day, and the option premium is held in the account until cash payment for the underlying asset or convertible security is received; or

(2) In the case of a short put, the creditor obtains cash in an amount equal to the exercise price or holds in the account cash equivalents with a current market value at least equal to the exercise price and, except in the case of money market mutual funds, with one year or less to maturity; or

(3) In the case of a short put or short call, the creditor verifies that the

appropriate escrow agreement will be delivered to the creditor promptly and the option premium is held in the account until such delivery is made; or

(4) Beginning June 1, 1997, any other transaction involving options or warrants in which the customer's risk is limited and all elements of the transaction are subject to contemporaneous exercise if:

(i) the amount at risk is held in the account in cash, cash equivalents, or via an escrow receipt; and

(ii) the transaction is eligible for the cash account by the rules of the registered national securities exchange authorized to trade the option or warrant or by the rules of the creditor's examining authority in the case of an unregistered option, provided that all such rules have been approved or amended by the SEC.

*Credit balance* means the cash amount due the customer in a margin account after debiting amounts transferred to the special memorandum account.

*Creditor* means any broker or dealer (as defined in sections 3(a)(4) and 3(a)(5) of the Act), any member of a national securities exchange, or any person associated with a broker or dealer (as defined in section 3(a)(18) of the Act), except for business entities controlling or under common control with the creditor.

*Customer* includes:

(1) Any person or persons acting jointly:

(i) To or for whom a creditor extends, arranges, or maintains any credit; or

(ii) who would be considered a customer of the creditor according to the ordinary usage of the trade;

(2) Any partner in a firm who would be considered a customer of the firm absent the partnership relationship; and

(3) Any joint venture in which a creditor participates and which would be considered a customer of the creditor if the creditor were not a participant.

*Debit balance* means the cash amount owed to the creditor in a margin account after debiting amounts transferred to the special memorandum account.

*Delivery against payment, Payment against delivery, or a C.O.D. transaction* refers to an arrangement under which a creditor and a customer agree that the creditor will deliver to, or accept from, the customer, or the customer's agent, a security against full payment of the purchase price.

*Equity* means the total current market value of security positions held in the margin account plus any credit balance less the debit balance in the margin account.

*Escrow agreement* means any agreement issued in connection with a call or put option under which a bank or any person designated as a control location under paragraph (c) of SEC Rule 15c3-3 (17 CFR 240.15c3-3(c)), holding the underlying asset or required cash or cash equivalents, is obligated to deliver to the creditor (in the case of a call option) or accept from the creditor (in the case of a put option) the underlying asset or required cash or cash equivalent against payment of the exercise price upon exercise of the call or put.

*Examining authority* means:

(1) The national securities exchange or national securities association of which a creditor is a member; or

(2) If a member of more than one self-regulatory organization, the organization designated by the SEC as the examining authority for the creditor.

*Exempted securities mutual fund* means any security issued by an investment company registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8), provided the company has at least 95 percent of its assets continuously invested in exempted securities (as defined in section 3(a)(12) of the Act).

*Foreign margin stock* means a foreign security that is an equity security and that appears on the Board's periodically published List of Foreign Margin Stocks.

*Foreign person* means a person other than a United States person as defined in section 7(f) of the Act.

*Foreign security* means a security issued in a jurisdiction other than the United States.

*Good faith margin* means the amount of margin which a creditor, exercising sound credit judgment, would customarily require for a specified security position and which is established without regard to the customer's other assets or securities positions held in connection with unrelated transactions.

*In or at the money* means, until June 1, 1997, the current market price of the underlying security is not more than one standard exercise interval below (with respect to a call option) or above (with respect to a put option) the exercise price of the option.

*In the money* means the current market price of the underlying asset or index is not below (with respect to a call option) or above (with respect to a put option) the exercise price of the option.

*Margin call* means a demand by a creditor to a customer for a deposit of additional cash or securities to eliminate or reduce a margin deficiency as required under this part.



**Margin deficiency** means the amount by which the required margin exceeds the equity in the margin account.

**Margin excess** means the amount by which the equity in the margin account exceeds the required margin. When the margin excess is represented by securities, the current value of the securities is subject to the percentages set forth in § 220.18 (the Supplement).

**Margin security** means:

- (1) Any registered security;
- (2) Any OTC margin stock;
- (3) Any OTC margin bond;
- (4) Any OTC security designated as qualified for trading in the National Market System under a designation plan approved by the Securities and Exchange Commission (NMS security);
- (5) Any security issued by either an open-end investment company or unit investment trust which is registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8);
- (6) Any foreign margin stock; or
- (7) Any debt security convertible into a margin security.

**Money market mutual fund** means any security issued by an investment company registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8) that is considered a money market fund under SEC Rule 2a-7 (17 CFR 270.2a-7).

**Nonexempted security** means any security other than an exempted security (as defined in section 3(a)(12) of the Act).

**Nonmember bank** means a bank that is not a member of the Federal Reserve System.

**Non-U.S. traded foreign security** means a foreign security that is neither a registered security nor one listed on NASDAQ.

**OTC margin bond** means:

- (1) A debt security not traded on a national securities exchange which meets all of the following requirements:

- (i) At the time of the original issue, a principal amount of not less than \$25,000,000 of the issue was outstanding;
- (ii) The issue was registered under section 5 of the Securities Act of 1933 (15 U.S.C. 77e) and the issuer either files periodic reports pursuant to section 13(a) or 15(d) of the Act or is an insurance company which meets all of the conditions specified in section 12(g)(2)(G) of the Act; and
- (iii) At the time of the extension of credit, the creditor has a reasonable basis for believing that the issuer is not in default on interest or principal payments; or

- (2) A private pass-through security (not guaranteed by an agency of the U.S. government) meeting all of the following requirements:

- (i) An aggregate principal amount of not less than \$25,000,000 (which may be issued in series) was issued pursuant to a registration statement filed with the SEC under section 5 of the Securities Act of 1933 (15 U.S.C. 77e);

- (ii) Current reports relating to the issue have been filed with the SEC; and

- (iii) At the time of the credit extension, the creditor has a reasonable basis for believing that mortgage interest, principal payments and other distributions are being passed through as required and that the servicing agent is meeting its material obligations under the terms of the offering; or

- (3) A mortgage related security as defined in section 3(a)(41) of the Act; or

- (4) A debt security issued or guaranteed as a general obligation by the government of a foreign country, its provinces, states, or cities, or a supranational entity, if at the time of the extension of credit one of the following is rated in one of the two highest rating categories by a nationally recognized statistical rating organization:

- (i) The issue;
- (ii) The issuer or guarantor (implicitly); or
- (iii) Other outstanding unsecured long-term debt securities issued or guaranteed by the government or entity; or

- (5) A foreign security that is a nonconvertible debt security that meets all of the following requirements:

- (i) At the time of original issue, a principal amount of at least \$100,000,000 was outstanding;

- (ii) At the time of the extension of credit, the creditor has a reasonable basis for believing that the issuer is not in default on interest or principal payments; and

- (iii) At the time of the extension of credit, the issue is rated in one of the two highest rating categories by a nationally recognized statistical rating organization; or

- (6) Any nonconvertible debt security that meets all of the following requirements:

- (i) At the time of the extension of credit, the creditor has a reasonable basis for believing that the issuer is not in default on interest or principal payments; and

- (ii) At the time of the extension of credit, the issue is rated in one of the four highest rating categories by a nationally recognized statistical rating organization.

**OTC margin stock** means any equity security traded over-the-counter that the Board has determined has the degree of national investor interest, the depth and breadth of market, the availability of information respecting the security and

its issuer, and the character and permanence of the issuer to warrant being treated like an equity security traded on a national securities exchange. An OTC stock is not considered to be an OTC margin stock unless it appears on the Board's periodically published list of OTC margin stocks.

**Overlying option** means:

- (1) A put option purchased or a call option written against a long position in an underlying asset in the specialist record in § 220.12(b); or

- (2) A call option purchased or a put option written against a short position in an underlying asset in the specialist record in § 220.12(b).

**Payment period** means the number of business days in the standard securities settlement cycle in the United States, as defined in paragraph (a) of SEC Rule 15c6-1 (17 CFR 240.15c6-1(a)), plus two business days.

**Permitted offset position** means, in the case of an option in which a specialist makes a market, a position in the underlying asset or other related assets, and in the case of other securities in which a specialist makes a market, a position in options overlying the securities in which a specialist makes a market, provided the positions qualify as permitted offsets under the rules of the national securities exchange with which the specialist is registered, and further provided all such rules have been approved or amended by the SEC. Until June 1, 1997, permitted offsets are determined by reference to section 220.12(b)(6).

**Purpose credit** means credit for the purpose of:

- (1) Buying, carrying, or trading in securities; or
- (2) Buying or carrying any part of an investment contract security which shall be deemed credit for the purpose of buying or carrying the entire security.

**Registered security** means any security that:

- (1) Is registered on a national securities exchange; or
- (2) Has unlisted trading privileges on a national securities exchange.

**Short call or short put** means a call option or a put option that is issued, endorsed, or guaranteed in or for an account.

- (1) A short call that is not cash-settled obligates the customer to sell the underlying asset at the exercise price upon receipt of a valid exercise notice or as otherwise required by the option contract.

- (2) A short put that is not cash-settled obligates the customer to purchase the underlying asset at the exercise price upon receipt of a valid exercise notice

or as otherwise required by the option contract.

(3) A short call or a short put that is cash-settled obligates the customer to pay the holder of an in the money long put or long call who has, or has been deemed to have, exercised the option the cash difference between the exercise price and the current assigned value of the option as established by the option contract.

*Specialist joint account* means an account which, by written agreement, provides for the commingling of the security positions of the participants and a sharing of profits and losses from the account on some predetermined ratio.

*Underlying asset* means:

(1) the security or other asset that will be delivered upon exercise of an option; or

(2) In the case of a cash-settled option, the securities or other assets which comprise the index or other measure from which the option's value is derived.

#### § 220.3 General provisions.

(a) *Records.* The creditor shall maintain a record for each account showing the full details of all transactions.

(b) *Separation of accounts.* Except as provided for in the margin account and the special memorandum account, the requirements of an account may not be met by considering items in any other account. If withdrawals of cash or securities are permitted under the regulation, written entries shall be made when cash or securities are used for purposes of meeting requirements in another account.

(c) *Maintenance of credit.* Except as prohibited by this part, any credit initially extended in compliance with this part may be maintained regardless of:

(1) Reductions in the customer's equity resulting from changes in market prices;

(2) Any security in an account ceasing to be margin or exempted; or

(3) Any change in the margin requirements prescribed under this part.

(d) *Guarantee of accounts.* No guarantee of a customer's account shall be given any effect for purposes of this part.

(e) *Receipt of funds or securities.* (1) A creditor, acting in good faith, may accept as immediate payment:

(i) Cash or any check, draft, or order payable on presentation; or

(ii) Any security with sight draft attached.

(2) A creditor may treat a security, check or draft as received upon written

notification from another creditor that the specified security, check, or draft has been sent.

(3) Upon notification that a check, draft, or order has been dishonored or when securities have not been received within a reasonable time, the creditor shall take the action required by this part when payment or securities are not received on time.

(4) To temporarily finance a customer's receipt of securities pursuant to an employee benefit plan registered on SEC Form S-8 or the withholding taxes for an employee stock award plan, a creditor may accept, in lieu of the securities, a properly executed exercise notice, where applicable, and instructions to the issuer to deliver the stock to the creditor. Prior to acceptance, the creditor must verify that the issuer will deliver the securities promptly and the customer must designate the account into which the securities are to be deposited.

(f) *Exchange of securities.* (1) To enable a customer to participate in an offer to exchange securities which is made to all holders of an issue of securities, a creditor may submit for exchange any securities held in a margin account, without regard to the other provisions of this part, provided the consideration received is deposited into the account.

(2) If a nonmargin, nonexempted security is acquired in exchange for a margin security, its retention, withdrawal, or sale within 60 days following its acquisition shall be treated as if the security is a margin security.

(g) *Valuing securities.* The current market value of a security shall be determined as follows:

(1) Throughout the day of the purchase or sale of a security, the creditor shall use the security's total cost of purchase or the net proceeds of its sale including any commissions charged.

(2) At any other time, the creditor shall use the closing sale price of the security on the preceding business day, as shown by any regularly published reporting or quotation service. If there is no closing price, the creditor may use any reasonable estimate of the market value of the security as of the close of business on the preceding business day.

(h) *Innocent mistakes.* If any failure to comply with this part results from a mistake made in good faith in executing a transaction or calculating the amount of margin, the creditor shall not be deemed in violation of this part if, promptly after the discovery of the mistake, the creditor takes appropriate corrective action.

(i) *Foreign currency.* Freely convertible foreign currency may be treated at its U.S. dollar equivalent, provided the currency is marked-to-market daily.

#### § 220.4 Margin account.

(a) *Margin transactions.* (1) All transactions not specifically authorized for inclusion in another account shall be recorded in the margin account.

(2) A creditor may establish separate margin accounts for the same person to:

(i) Clear transactions for other creditors where the transactions are introduced to the clearing creditor by separate creditors; or

(ii) Clear transactions through other creditors if the transactions are cleared by separate creditors; or

(iii) Provide one or more accounts over which the creditor or a third party investment adviser has investment discretion.

(b) *Required margin—(1) Applicability.* The required margin for each long or short position in securities is set forth in § 220.18 (the Supplement) and is subject to the following exceptions and special provisions.

(2) *Short sale against the box.* A short sale "against the box" shall be treated as a long sale for the purpose of computing the equity and the required margin.

(3) *When-issued securities.* The required margin on a net long or net short commitment in a when-issued security is the margin that would be required if the security were an issued margin security, plus any unrealized loss on the commitment or less any unrealized gain.

(4) *Stock used as cover.* (i) When a short position held in the account serves in lieu of the required margin for a short put, the amount prescribed by paragraph (b)(1) of this section as the amount to be added to the required margin in respect of short sales shall be increased by any unrealized loss on the position.

(ii) When a security held in the account serves in lieu of the required margin for a short call, the security shall be valued at no greater than the exercise price of the short call.

(5) *Accounts of partners.* If a partner of the creditor has a margin account with the creditor, the creditor shall disregard the partner's financial relations with the firm (as shown in the partner's capital and ordinary drawing accounts) in calculating the margin or equity of the partner's margin account.

(6) *Contribution to joint venture.* If a margin account is the account of a joint venture in which the creditor participates, any interest of the creditor in the joint account in excess of the

interest which the creditor would have on the basis of its right to share in the profits shall be treated as an extension of credit to the joint account and shall be margined as such.

(7) *Transfer of accounts.* (i) A margin account that is transferred from one creditor to another may be treated as if it had been maintained by the transferee from the date of its origin, if the transferee accepts, in good faith, a signed statement of the transferor (or, if that is not practicable, of the customer), that any margin call issued under this part has been satisfied.

(ii) A margin account that is transferred from one customer to another as part of a transaction, not undertaken to avoid the requirements of this part, may be treated as if it had been maintained for the transferee from the date of its origin, if the creditor accepts in good faith and keeps with the transferee account a signed statement of the transferor describing the circumstances for the transfer.

(8) *Credit denominated in foreign currency.* A creditor may extend credit denominated in any freely convertible foreign currency.

(9) *Options.* The following provisions are in force until June 1, 1997:

(i) *Margin or cover for options on exempted debt securities, certificates of deposit, stock indices, or securities exchange traded options on foreign currencies.* The required margin for each transaction involving any short put or short call on an exempted debt security, certificate of deposit, stock index, or foreign currency (if the option is traded on a securities exchange), shall be the amount or position in lieu of margin set forth in § 220.18 (the Supplement).

(ii) *Margin for options on equity securities.* The required margin for each transaction involving any short put or short call on an equity security shall be the amount set forth in § 220.18 (the Supplement).

(iii) *Cover or positions in lieu of margin.* No margin is required for an option written on an equity security position when the account holds any of the following:

(A) The underlying asset in the case of a short call, or a short position in the underlying asset in the case of a short put;

(B) Securities immediately convertible into or exchangeable for the underlying asset without the payment of money in the case of a short call, if the right to convert or exchange does not expire on or before the expiration date of the short call;

(C) An escrow agreement for the underlying security or foreign exchange

(in the case of a short call) or cash (in the case of a short put);

(D) A long call on the same number of shares of the same underlying asset if the long call does not expire before the expiration date of the short call, and if the amount (if any), by which the exercise price of the long call exceeds the exercise price of the short call is deposited in the account;

(E) A long put on the same number of shares of the same underlying asset if the long put does not expire before the expiration date of the short put, and if the amount (if any), by which the exercise price of the short put exceeds the exercise price of the long put is deposited in the account;

(F) A warrant to purchase the underlying asset, in the case of a short call, if the warrant does not expire on or before the expiration date of the short call, and if the amount (if any), by which the exercise price of the short call is deposited in the account. A warrant used in lieu of the required margin under this provision shall contribute no equity to the account.

(iv) *Straddles.* When both a short put and a short call are in a margin account on the same number of shares of the same underlying security, the required margin shall be the margin on either the short put or the short call, whichever is greater, plus any unrealized loss on the other option.

(v) *Exclusive designation.* The customer may designate at the time the option order is entered which security position held in the account is to serve in lieu of the required margin, if such service is offered by the creditor; or the customer may have a standing agreement with the creditor as to the method to be used for determining on any given day which security position will be used in lieu of the margin to support an option transaction. Any security held in the account which serves in lieu of the required margin for a short put or a short call shall be unavailable to support any other option transaction in the account.

(c) *When additional margin is required—(1) Computing deficiency.* All transactions on the same day shall be combined to determine whether additional margin is required by the creditor. For the purpose of computing equity in an account, security positions are established or eliminated and a credit or debit created on the trade date of a security transaction. Additional margin is required on any day when the day's transactions create or increase a margin deficiency in the account and shall be for the amount of the margin deficiency so created or increased.

(2) *Satisfaction of deficiency.* The additional required margin may be satisfied by a transfer from the special memorandum account or by a deposit of cash, margin securities, exempted securities, or any combination thereof.

(3) *Time limits.* (i) A margin call shall be satisfied within one payment period after the margin deficiency was created or increased.

(ii) The payment period may be extended for one or more limited periods upon application by the creditor to its examining authority unless the examining authority believes that the creditor is not acting in good faith or that the creditor has not sufficiently determined that exceptional circumstances warrant such action. Applications shall be filed and acted upon prior to the end of the payment period or the expiration of any subsequent extension.

(4) *Satisfaction restriction.* Any transaction, position, or deposit that is used to satisfy one requirement under this part shall be unavailable to satisfy any other requirement.

(d) *Liquidation in lieu of deposit.* If any margin call is not met in full within the required time, the creditor shall liquidate securities sufficient to meet the margin call or to eliminate any margin deficiency existing on the day such liquidation is required, whichever is less. If the margin deficiency created or increased is \$1000 or less, no action need be taken by the creditor.

(e) *Withdrawals of cash or securities.* (1) Cash or securities may be withdrawn from an account, except if:

(i) Additional cash or securities are required to be deposited into the account for a transaction on the same or a previous day; or

(ii) The withdrawal, together with other transactions, deposits, and withdrawals on the same day, would create or increase a margin deficiency.

(2) Margin excess may be withdrawn or may be transferred to the special memorandum account (§ 220.5) by making a single entry to that account which will represent a debit to the margin account and a credit to the special memorandum account.

(3) If a creditor does not receive a distribution of cash or securities which is payable with respect to any security in a margin account on the day it is payable and withdrawal would not be permitted under paragraph (e) of this section, a withdrawal transaction shall be deemed to have occurred on the day the distribution is payable.

(f) *Interest, service charges, etc.* (1) Without regard to the other provisions of this section, the creditor, in its usual practice, may debit the following items

to a margin account if they are considered in calculating the balance of such account:

- (i) Interest charged on credit maintained in the margin account;
- (ii) Premiums on securities borrowed in connection with short sales or to effect delivery;
- (iii) Dividends, interest, or other distributions due on borrowed securities;

(iv) Communication or shipping charges with respect to transactions in the margin account; and

- (v) Any other service charges which the creditor may impose.

(2) A creditor may permit interest, dividends, or other distributions credited to a margin account to be withdrawn from the account if:

- (i) The withdrawal does not create or increase a margin deficiency in the account; or

(ii) The current market value of any securities withdrawn does not exceed 10 percent of the current market value of the security with respect to which they were distributed.

#### § 220.5 Special memorandum account.

(a) A special memorandum account (SMA) may be maintained in conjunction with a margin account. A single entry amount may be used to represent both a credit to the SMA and a debit to the margin account. A transfer between the two accounts may be effected by an increase or reduction in the entry. When computing the equity in a margin account, the single entry amount shall be considered as a debit in the margin account. A payment to the customer or on the customer's behalf or a transfer to any of the customer's other accounts from the SMA reduces the single entry amount.

(b) The SMA may contain the following entries:

- (1) Dividend and interest payments;
- (2) Cash not required by this part, including cash deposited to meet a maintenance margin call or to meet any requirement of a self-regulatory organization that is not imposed by this part;
- (3) Proceeds of a sale of securities or cash no longer required on any expired or liquidated security position that may be withdrawn under § 220.4(e); and
- (4) Margin excess transferred from the margin account under § 220.4(e)(2).

#### § 220.6 Government securities account.

In a government securities account, a creditor may effect and finance transactions involving government securities, provided the transaction is not prohibited by section 15C of the Act or any rule thereunder.

#### § 220.7 Arbitrage account.

In an arbitrage account a creditor may effect and finance for any customer bona fide arbitrage transactions. For the purpose of this section, the term "bona fide arbitrage" means:

(a) A purchase or sale of a security in one market together with an offsetting sale or purchase of the same security in a different market at as nearly the same time as practicable for the purpose of taking advantage of a difference in prices in the two markets; or

(b) A purchase of a security which is, without restriction other than the payment of money, exchangeable or convertible within 90 calendar days of the purchase into a second security together with an offsetting sale of the second security at or about the same time, for the purpose of taking advantage of a concurrent disparity in the prices of the two securities.

#### § 220.8 Cash account.

(a) *Permissible transactions.* In a cash account, a creditor, may:

(1) Buy for or sell to any customer any security or other asset if:

(i) There are sufficient funds in the account; or

(ii) The creditor accepts in good faith the customer's agreement that the customer will promptly make full cash payment for the security or asset before selling it and does not contemplate selling it prior to making such payment;

(2) Buy from or sell for any customer any security or other asset if:

(i) The security is held in the account; or

(ii) The creditor accepts in good faith the customer's statement that the security is owned by the customer or the customer's principal, and that it will be promptly deposited in the account;

(3) Issue, endorse, or guarantee, or sell an option for any customer as part of a covered option transaction; and

(4) Use an escrow agreement in lieu of the cash, cash equivalents or underlying asset position if:

(i) In the case of a short call or a short put, the creditor is advised by the customer that the required securities, assets or cash are held by a person authorized to issue an escrow agreement and the creditor independently verifies that the appropriate escrow agreement will be delivered by the person promptly; or

(ii) In the case of a call issued, endorsed, guaranteed, or sold on the same day the underlying asset is purchased in the account and the underlying asset is to be delivered to a person authorized to issue an escrow agreement, the creditor verifies that the

appropriate escrow agreement will be delivered by the person promptly.

(b) *Time periods for payment; cancellation or liquidation—*(1) *Full cash payment.* A creditor shall obtain full cash payment for customer purchases—

(i) Within one payment period of the date:

(A) Any nonexempted security was purchased;

(B) Any when-issued security was made available by the issuer for delivery to purchasers;

(C) Any "when distributed" security was distributed under a published plan;

(D) A security owned by the customer has matured or has been redeemed and a new refunding security of the same issuer has been purchased by the customer, provided:

(1) The customer purchased the new security no more than 35 calendar days prior to the date of maturity or redemption of the old security;

(2) The customer is entitled to the proceeds of the redemption; and

(3) The delayed payment does not exceed 103 percent of the proceeds of the old security.

(ii) In the case of the purchase of a foreign security, within one payment period of the trade date or within one day after the date on which settlement is required to occur by the rules of the foreign securities market, provided this period does not exceed the maximum time permitted by this part for delivery against payment transactions.

(2) *Delivery against payment.* If a creditor purchases for or sells to a customer a security in a delivery against payment transaction, the creditor shall have up to 35 calendar days to obtain payment if delivery of the security is delayed due to the mechanics of the transaction and is not related to the customer's willingness or ability to pay.

(3) *Shipment of securities, extension.* If any shipment of securities is incidental to consummation of a transaction, a creditor may extend the payment period by the number of days required for shipment, but not by more than one additional payment period.

(4) *Cancellation; liquidation; minimum amount.* A creditor shall promptly cancel or otherwise liquidate a transaction or any part of a transaction for which the customer has not made full cash payment within the required time. A creditor may, at its option, disregard any sum due from the customer not exceeding \$1000.

(c) *90 day freeze.* (1) If a nonexempted security in the account is sold or delivered to another broker or dealer without having been previously paid for in full by the customer, the privilege of

delaying payment beyond the trade date shall be withdrawn for 90 calendar days following the date of sale of the security. Cancellation of the transaction other than to correct an error shall constitute a sale.

(2) The 90 day freeze shall not apply if:

(i) Within the period specified in paragraph (b)(1) of this section, full payment is received or any check or draft in payment has cleared and the proceeds from the sale are not withdrawn prior to such payment or check clearance; or

(ii) The purchased security was delivered to another broker or dealer for deposit in a cash account which holds sufficient funds to pay for the security. The creditor may rely on a written statement accepted in good faith from the other broker or dealer that sufficient funds are held in the other cash account.

(d) *Extension of time periods; transfers.* (1) Unless the creditor's examining authority believes that the creditor is not acting in good faith or that the creditor has not sufficiently determined that exceptional circumstances warrant such action, it may upon application by the creditor:

(i) Extend any period specified in paragraph (b) of this section;

(ii) Authorize transfer to another account of any transaction involving the purchase of a margin or exempted security; or

(iii) Grant a waiver from the 90 day freeze.

(2) Applications shall be filed and acted upon prior to the end of the payment period, or in the case of the purchase of a foreign security within the period specified in paragraph (b)(1)(ii) of this section, or the expiration of any subsequent extension.

#### § 220.9 Nonsecurities credit and employee stock ownership account.

(a) In a nonsecurities credit account a creditor may:

(1) Effect and carry transactions in commodities;

(2) Effect and carry transactions in foreign-exchange;

(3) Extend and maintain secured or unsecured nonpurpose credit, subject to the requirements of paragraph (b) of this section; and

(4) Extend and maintain credit to employee stock ownership plans without regard to the other sections of this part.

(b) Every extension of credit, except as provided in paragraphs (a)(1) and (a)(2) of this section, shall be deemed to be purpose credit unless, prior to extending the credit, the creditor

accepts in good faith from the customer a written statement that it is not purpose credit. The statement shall conform to the requirements established by the Board. To accept the customer's statement in good faith, the creditor shall be aware of the circumstances surrounding the extension of credit and shall be satisfied that the statement is truthful.

#### § 220.10 Omnibus account.

(a) In an omnibus account, a creditor may effect and finance transactions for a broker or dealer who is registered with the SEC under section 15 of the Act and who gives the creditor written notice that:

(1) All securities will be for the account of customers of the broker or dealer; and

(2) Any short sales effected will be short sales made on behalf of the customers of the broker or dealer other than partners.

(b) The written notice required by paragraph (a) of this section shall conform to any SEC rule on the hypothecation of customers' securities by brokers or dealers.

#### § 220.11 Broker-dealer credit account.

(a) *Permissible transactions.* In a broker-dealer credit account, a creditor may:

(1) Purchase any security from or sell any security to another creditor or person regulated by a foreign securities authority under a good faith agreement to promptly deliver the security against full payment of the purchase price.

(2) Effect or finance transactions of any of its owners if the creditor is a clearing and servicing broker or dealer owned jointly or individually by other creditors.

(3) Extend and maintain credit to any partner or stockholder of the creditor for the purpose of making a capital contribution to, or purchasing stock of, the creditor, affiliated corporation or another creditor.

(4) Extend and maintain, with the approval of the appropriate examining authority:

(i) Credit to meet the emergency needs of any creditor; or

(ii) Subordinated credit to another creditor for capital purposes, if the other creditor:

(A) Is an affiliated corporation or would not be considered a customer of the lender apart from the subordinated loan; or

(B) Will not use the proceeds of the loan to increase the amount of dealing in securities for the account of the creditor, its firm or corporation or an affiliated corporation.

(5) Effect transactions for a customer as part of a "prime broker" arrangement in conformity with SEC guidelines.

(b) *Affiliated corporations.* For purposes of paragraphs (a)(3) and (a)(4) of this section "affiliated corporation" means a corporation all the common stock of which is owned directly or indirectly by the firm or general partners and employees of the firm, or by the corporation or holders of the controlling stock and employees of the corporation and the affiliation has been approved by the creditor's examining authority.

#### § 220.12 Market functions account.

(a) *Requirements.* In a market functions account, a creditor may effect or finance the transactions of market participants in accordance with the following provisions. A separate record shall be kept for the transactions specified for each category described in paragraphs (b) through (e) of this section. Any position in a separate record shall not be used to meet the requirements of any other category.

(b) *Specialists.*—(1) *Applicability.* A creditor may clear or finance specialist transactions and permitted offset positions for any specialist, or any specialist joint account, in which all participants, or all participants other than the creditor, are registered as specialists on a national securities exchange that requires regular reports on the use of specialist credit from the registered specialists.

(2) *Required margin.* The required margin for a specialist's transactions shall be:

(i) Good faith margin for:

(A) Any long or short position in a security in which the specialist makes a market;

(B) Any wholly-owned margin security or exempted security; or

(C) Any permitted offset position.

(ii) The margin prescribed by § 220.18 (the Supplement) when a security purchased or sold short in the account does not qualify as a specialist or permitted offset position.

(3) *Additional margin; restriction on "free-riding."* (i) Except as required by paragraph (b)(4) of this section, the creditor shall issue a margin call on any day when additional margin is required as a result of specialist transactions. The creditor may allow the specialist a maximum of one payment period to satisfy a margin call.

(ii) If a specialist fails to satisfy a margin call within the period specified in paragraph (b)(3) of this section (and the creditor is required to liquidate securities to satisfy the call), the creditor shall be prohibited for a 15 calendar day



period from extending any further credit to the specialist to finance transactions in non-specialty securities.

(iii) The restriction on "free-riding" shall not apply to:

(A) Any specialist on a national securities exchange that has an SEC-approved rule on "free-riding" by specialists; or

(B) the acquisition or liquidation of a permitted offset position.

(4) *Deficit status.* On any day when a specialist's separate record would liquidate to a deficit, the creditor shall not extend any further specialist credit in the account and shall issue a margin call at least as large as the deficit. If the call is not met by noon of the following business day, the creditor shall liquidate positions in the specialist's account.

(5) *Withdrawals.* Withdrawals may be permitted to the extent that the equity exceeds the margin requirements specified in paragraph (b)(2) of this section.

(6) *Permitted offset positions.* Until June 1, 1997, a specialist in options may establish, on a share-for-share basis, a long or short position in the securities underlying the options in which the specialist makes a market, and a specialist in securities other than options may purchase or write options overlying the securities in which the specialist makes a market, if the account holds the following permitted offset positions:

(i) A short option position which is "in or at the money" and is not offset by a long or short option position for an equal or greater number of shares of the same underlying security which is "in the money";

(ii) A long option position which is "in or at the money" and is not offset by a long or short option position for an equal or greater number of shares of the same underlying security which is "in the money";

(iii) A short option position against which an exercise notice was tendered;

(iv) A long option position which was exercised;

(v) A net long position in a security (other than an option) in which the specialist makes a market; or

(vi) A net short position in a security (other than an option) in which the specialist makes a market.

(c) *Underwriters and distributors.* A creditor may effect or finance for any dealer or group of dealers transactions for the purpose of facilitating the underwriting or distribution of all or a part of an issue of securities with a good faith margin.

(d) *OTC marketmakers and third marketmakers.* (1) A creditor may clear or finance with a good faith margin,

marketmaking transactions for a creditor who is a registered NASDAQ marketmaker or a qualified third marketmaker as defined in SEC Rule 3b-8 (17 CFR 240.3b-8).

(2) If the credit extended to a marketmaker ceases to be for the purpose of marketmaking, or the dealer ceases to be a marketmaker for an issue of securities for which credit was extended, the credit shall be subject to the margin specified in § 220.18 (the Supplement).

(e) *Odd-lot dealers.* A creditor may clear and finance odd-lot transactions for any creditor who is registered as an odd-lot dealer on a national securities exchange with a good faith margin.

#### § 220.13 Arranging for loans by others.

A creditor may arrange for the extension or maintenance of credit to or for any customer by any person, provided the creditor does not willfully arrange credit that violates parts 207, 221, or 224 of this chapter.

#### § 220.14 Clearance of securities, options, and futures.

(a) *Credit for clearance of securities.* The provisions of this part shall not apply to the extension or maintenance of any credit that is not for more than one day if it is incidental to the clearance of transactions in securities directly between members of a national securities exchange or association or through any clearing agency registered with the SEC.

(b) *Deposit of securities with a clearing agency.* The provisions of this part shall not apply to the deposit of securities with an options or futures clearing agency for the purpose of meeting the deposit requirements of the agency if:

(1) The clearing agency:

(i) Issues, guarantees performance on, or clears transactions in, any security (including options on any security, certificate of deposit, securities index or foreign currency); or

(ii) Guarantees performance of contracts for the purchase or sale of a commodity for future delivery or options on such contracts;

(2) The clearing agency is registered with the Securities and Exchange Commission or is the clearing agency for a contract market regulated by the Commodity Futures Trading Commission; and

(3) The deposit consists of any margin security and complies with the rules of the clearing agency that have been approved by the Securities and Exchange Commission or the Commodity Futures Trading Commission.

#### § 220.15 Borrowing by creditors.

(a) *Restrictions on borrowing.* A creditor may not borrow in the ordinary course of business as a broker or dealer using as collateral any registered nonexempted security, except:

(1) From or through a member bank of the Federal Reserve System; or

(2) From any nonmember bank that has filed with the Board an agreement as prescribed in paragraph (b) of this section, which agreement is still in effect; or

(3) From another creditor if the loan is permissible under this part.

(b) *Agreements of nonmember banks.*

(1) A nonmember bank shall file an agreement that conforms to the requirements of section 8(a) of the Act (See Form FR T-1, T-2).

(2) Any nonmember bank may terminate its agreement if it obtains the written consent of the Board.

#### § 220.16 Borrowing and lending securities.

(a) Without regard to the other provisions of this part, a creditor may borrow or lend securities for the purpose of making delivery of the securities in the case of short sales, failure to receive securities required to be delivered, or other similar situations. Each borrowing shall be secured by a deposit of one or more of the following: cash, cash equivalents, foreign sovereign nonconvertible debt securities that are margin securities, collateral acceptable for borrowings of securities pursuant to SEC Rule 15c3-3 (17 CFR 240.15c3-3), or irrevocable letters of credit issued by a bank insured by the Federal Deposit Insurance Corporation or a foreign bank that has filed an agreement with the Board on Form FR T-1, T-2. Such deposit made with the lender of the securities shall have at all times a value at least equal to 100 percent of the market value of the securities borrowed, computed as of the close of the preceding business day. If a creditor reasonably anticipates a short sale, such borrowing may be made up to one standard settlement cycle in advance of trade date.

(b) A creditor may lend non-U.S. traded foreign securities to a foreign person (or borrow such securities for the purpose of relending them to a foreign person) for any purpose lawful in the country in which they are to be used. Each borrowing shall be secured with collateral having at all times a value at least equal to 100 percent of the market value of the securities borrowed, computed as of the close of the preceding business day.

**§ 220.17 Requirements for the list of marginable OTC stocks and the list of foreign margin stocks.**

(a) *Requirements for inclusion on the list of marginable OTC stocks.* Except as provided in paragraph (f) of this section, OTC margin stock shall meet the following requirements:

(1) Four or more dealers stand willing to, and do in fact, make a market in such stock and regularly submit bona fide bids and offers to an automated quotations system for their own accounts;

(2) The minimum average bid price of such stock, as determined by the Board, is at least \$5 per share;

(3) The stock is registered under section 12 of the Act, is issued by an insurance company subject to section 12(g)(2)(G) of the Act, is issued by a closed-end investment management company subject to registration pursuant to section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8), is an American Depository Receipt (ADR) of a foreign issuer whose securities are registered under section 12 of the Act, or is a stock of an issuer required to file reports under section 15(d) of the Act;

(4) Daily quotations for both bid and asked prices for the stock are continuously available to the general public;

(5) The stock has been publicly traded for at least six months;

(6) The issuer has at least \$4 million of capital, surplus, and undivided profits;

(7) There are 400,000 or more shares of such stock outstanding in addition to shares held beneficially by officers, directors or beneficial owners of more than 10 percent of the stock;

(8) There are 1,200 or more holders of record, as defined in SEC Rule 12g5-1 (17 CFR 240.12g5-1), of the stock who are not officers, directors or beneficial owners of 10 percent or more of the stock, or the average daily trading volume of such stock as determined by the Board, is at least 500 shares; and

(9) The issuer or a predecessor in interest has been in existence for at least three years.

(b) *Requirements for continued inclusion on the list of marginable OTC stocks.* Except as provided in paragraph (f) of this section, OTC margin stock shall meet the following requirements:

(1) Three or more dealers stand willing to, and do in fact, make a market in such stock and regularly submit bona fide bids and offers to an automated quotations system for their own accounts;

(2) The minimum average bid price of such stocks, as determined by the Board, is at least \$2 per share;

(3) The stock is registered as specified in paragraph (a)(3) of this section;

(4) Daily quotations for both bid and asked prices for the stock are continuously available to the general public;

(5) The issuer has at least \$1 million of capital, surplus, and undivided profits;

(6) There are 300,000 or more shares of such stock outstanding in addition to shares held beneficially by officers, directors, or beneficial owners of more than 10 percent of the stock; and

(7) There continue to be 800 or more holders of record, as defined in SEC Rule 12g5-1 (17 CFR 240.12g5-1), of the stock who are not officers, directors, or beneficial owners of 10 percent or more of the stock, or the average daily trading volume of such stock, as determined by the Board, is at least 300 shares.

(c) *Requirements for inclusion on the list of foreign margin stocks.* Except as provided in paragraph (f) of this section, a foreign margin stock shall be a foreign security deemed to have a "ready market" for purposes of SEC Rule 15c3-1 (17 CFR 240.15c3-1) or meet the following requirements:

(1) The security is listed for trading on or through the facilities of a foreign securities exchange or a recognized foreign securities market and has been trading on such exchange or market for at least six months;

(2) Daily quotations for both bid and asked or last sale prices for the security provided by the foreign securities exchange or foreign securities market on which the security is traded are continuously available to creditors in the United States pursuant to an electronic quotation system;

(3) The aggregate market value of shares, the ownership of which is unrestricted, is not less than \$1 billion;

(4) The average weekly trading volume of such security during the preceding six months is either at least 200,000 shares or \$1 million; and

(5) The issuer or a predecessor in interest has been in existence for at least five years.

(d) *Requirements for continued inclusion on the list of foreign margin stocks.* Except as provided in paragraph (f) of this section, a foreign margin stock shall be a foreign security deemed to have a "ready market" for purposes of SEC Rule 15c3-1 (17 CFR 240.15c3-1) or meet the following requirements:

(1) The security continues to meet the requirements specified in paragraphs (c) (1) and (2) of this section;

(2) The aggregate market value of shares, the ownership of which is unrestricted, is not less than \$500 million; and

(3) The average weekly trading volume of such security during the preceding six months is either at least 100,000 shares or \$500,000.

(e) *Removal from the lists.* The Board shall periodically remove from the lists any stock that:

(1) Ceases to exist or of which the issuer ceases to exist; or

(2) No longer substantially meets the provisions of paragraph (b) or (d) of this section or the definition of OTC margin stock.

(f) *Discretionary authority of Board.* Without regard to other paragraphs of this section, the Board may add to, or omit or remove from the list of marginable OTC stocks and the list of foreign margin stocks and equity security, if in the judgment of the Board, such action is necessary or appropriate in the public interest.

(g) *Unlawful representations.* It shall be unlawful for any creditor to make, or cause to be made, any representation to the effect that the inclusion of a security on the list of marginable OTC stocks or the list of foreign margin stocks is evidence that the Board or the SEC has in any way passed upon the merits of, or given approval to, such security or any transactions therein. Any statement in an advertisement or other similar communication containing a reference to the Board in connection with the lists or stocks on those lists shall be an unlawful representation.

**§ 220.18 Supplement: Margin requirements.**

The required margin for each security position held in a margin account shall be as follows:

(a) Margin equity security, except for an exempted security, money market mutual fund or exempted securities mutual fund, warrant on a securities index or foreign currency or a long position in an option: 50 percent of the current market value of the security or the percentage set by the regulatory authority where the trade occurs, whichever is greater.

(b) Exempted security, registered nonconvertible debt security, OTC margin bond, money market mutual fund or exempted securities mutual fund: The margin required by the creditor in good faith or the percentage set by the regulatory authority where the trade occurs, whichever is greater.

(c) Short sale of a nonexempted security, except for a registered nonconvertible debt security or OTC margin bond: 150 percent of the current

market value of the security, or 100 percent of the current market value if a security exchangeable or convertible within 90 calendar days without restriction other than the payment of money into the security sold short is held in the account.

(d) Short sale of an exempted security, registered nonconvertible debt security or OTC margin bond: 100 percent of the current market value of the security plus the margin required by the creditor in good faith.

(e) Nonmargin, nonexempted security: 100 percent of the current market value.

(f) Put or call on a security, certificate of deposit, securities index or foreign currency or a warrant on a securities index or foreign currency:

(1) In the case of puts and calls issued by a registered clearing corporation and listed or traded on a registered national securities exchange or a registered securities association and registered warrants on a securities index or foreign currency, the amount, or other position (except in the case of an option on an equity security until June 1, 1997), specified by the rules of the registered national securities exchange or the registered securities association authorized to trade the option or warrant, provided that all such rules have been approved or amended by the SEC; or

(2) In the case of all other puts and calls, the amount, or other position, specified by the maintenance rules of the creditor's examining authority.

**§ 220.19 [Removed]**

3. Section 220.19 is removed.

§§ 220.106, 220.107, 220.109, 220.112, 220.114-220.116, 220.120, 220.125, 220.129, 220.130 [Removed]

**Interpretations**

4. The following sections are removed and reserved: 220.106, 220.107, 220.109, 220.112, 220.114, 220.115, 220.116, 220.120, 220.125, 220.129, and 220.130.

By order of the Board of Governors of the Federal Reserve System, April 24, 1996.

William W. Wiles,

Secretary of the Board.

[FR Doc. 96-10607 Filed 5-3-96; 8:45 am]

BILLING CODE 6210-01-P





# Regulations/Operations

Federal Reserve Bank of Minneapolis  
250 Marquette Avenue  
Minneapolis, MN 55401-2171

Subject: **Proposed Amendments to  
Regulations G, T and U**

Date: **May 20, 1996**

To All Banks, Multi-Bank Holding  
Companies and Others Concerned  
in the Ninth Federal Reserve District:

RE: Docket No. R-0923

## Summary:

The Federal Reserve Board has issued for public comment a proposed rule amending the Board's margin regulations.

The proposed amendments would:

- allow broker-dealers to extend good faith credit on any non-equity security rather than only those currently permitted in the Board's rules;
- allow transactions involving non-equity securities to be effected in an account not subject to the restrictions of Regulation T's margin account;
- remove restrictions on the ability of broker-dealers to calculate required margin for non-equity securities on a "portfolio" basis;
- relax the Board's collateral requirements for the borrowing and lending of securities; and
- exempt from Regulation T any credit extended abroad by a U.S. broker-dealer or foreign securities to foreign persons.

The proposal also seeks comment on whether the Board should expand the number of equity securities eligible for loan value under Regulation T, and whether the Board should amend Regulation G and U to modify their method for determining which equity securities are eligible for loan value.

More broadly, the proposal seeks comment on any other steps the Board could take to reduce the burden imposed by Regulation T, including any steps to reduce the accounting and recordkeeping aspects of the regulation that would be consistent with the purposes and requirements of the Securities and Exchange Act of 1934.

The *Federal Register* notice is attached.

## How to Respond:

Comments must be submitted by July 1, 1996. All comments should refer to Docket No. R-0923, and should be mailed to Mr. William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW, Washington, DC 20551.

## Who to Call:

For questions on the above:  
Ron J. Feldman, Financial Specialist, Banking Supervision (612) 340-7702

In-Wats Phone Numbers for those calling from:

Minnesota 800-552-7225 Michigan, Wisconsin 800-328-7161  
Minnesota 800-552-8355 North Dakota, South Dakota 800-328-7161

Federal Reserve Bank of Minneapolis (612) 340-2345  
Toll-Free Minnesota 800-552-8355

**FEDERAL RESERVE SYSTEM****12 CFR Parts 207, 220, and 221**

[Regulations G, T, and U; Docket No. R-0923]

**Securities Credit Transactions**

**AGENCY:** Board of Governors of the Federal Reserve System.

**ACTION:** Proposed rule.

**SUMMARY:** In conjunction with a final rule printed elsewhere in today's Federal Register, the Board is considering further amendments to its margin regulations, Regulations G, T, and U. Regulation T covers extensions of credit by and to brokers and dealers; Regulation U covers extensions of credit by banks; and Regulation G covers extensions of credit by all other U.S. lenders.

The Board is proposing to: allow a broker-dealer to extend "good faith" credit on any non-equity security rather than only those currently permitted by Board rules; allow lending on non-equity securities to occur in a new "non-equity" account, absent the restrictions currently imposed in the margin account; remove restrictions on the ability of broker-dealers to calculate required margin for non-equity securities on a "portfolio" basis; ease or eliminate the Board's collateral requirements for the borrowing and lending of securities; exempt lending to foreign persons on foreign securities by foreign branches of U.S. broker dealers; remove a Board interpretation that prevents options from serving as cover in lieu of margin for a short sale; and allow banks to lend against exchange-traded options to the extent permitted by the exchange listing the option.

The Board is also seeking comment on whether it should expand the number of equity securities eligible for loan value under Regulation T, and on whether it should amend Regulations G and U to modify their method for determining which equity securities are eligible for loan value.

**DATES:** Comments should be received on or before July 1, 1996.

**ADDRESSES:** Comments should refer to Docket No. R-0923, and may be mailed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue NW., Washington, DC 20551. Comments also may be delivered to Room B-222 of the Eccles Building between 8:45 a.m. and 5:15 p.m. weekdays, or to the guard station in the Eccles Building courtyard on 20th Street NW. (between Constitution Avenue and

C Street NW.) at any time. Comments received will be available for inspection in Room MP-500 of the Martin Building between 9:00 a.m. and 5:00 p.m. weekdays, except as provided in 12 CFR 261.8 of the Board's rules regarding availability of information.

**FOR FURTHER INFORMATION CONTACT:** Scott Holz, Senior Attorney, or Angela Desmond, Senior Counsel, Division of Banking Supervision and Regulation (202) 452-2781; Oliver Ireland, Associate General Counsel (202) 452-3625 or Gregory Baer, Managing Senior Counsel (202) 452-3236; Legal Division; for the hearing impaired only, Telecommunications Device for the Deaf (TDD), Dorothea Thompson (202) 452-3544.

**SUPPLEMENTARY INFORMATION:** Regulation T implements the Board's authority over securities credit extended by broker-dealers under section 7 of the Securities Exchange Act of 1934, 15 U.S.C. 78g (the Act). Section 7 requires the Board to regulate the amount of credit that may be extended on securities by a broker-dealer, requires that collateral for securities purchases consist of "exempted securities" (U.S. government and municipal securities) or securities assigned loan value by the Board, and prohibits a broker-dealer from extending unsecured credit for the purpose of purchasing securities. Regulation T establishes the margin that a customer of a broker-dealer must post when engaging in a securities transaction on credit. The "margin" for a security is the converse of the security's "loan value;" by definition, the two always add up to 100 percent.

Section 7 also authorizes the Board to regulate credit extended by banks and all other U.S. lenders. Regulation U limits credit extended by banks to finance the purchase or carrying by customers of margin equity securities when the credit is collateralized by such securities. 12 CFR Part 221. Regulation G limits credit extended by lenders other than broker-dealers and banks to finance the purchase or carrying of margin equity securities when the credit is collateralized by such securities. 12 CFR Part 207.<sup>1</sup>

In 1995, the Board published for comment a series of amendments to Regulation T that were intended to remove constraints that were hampering developing trends in the securities markets. 60 FR 33763, June 29, 1995.

<sup>1</sup> Regulation X covers U.S. borrowers obtaining credit outside the United States. Because Regulation X incorporates the requirements of Regulation T, U, or G (depending on the lender), any amendments to those regulations automatically pass through to Regulation X. Therefore, no amendments to Regulation X are being proposed.

These trends included the erosion of barriers between broker-dealers and other lenders, the globalization of securities markets, the increasing overlap in the businesses of various lenders, and the constant development of new mechanisms for extending securities credit. The Board also solicited comment on broader changes that could be made to Regulation T. The recent effort to modernize Regulation T predated but is now encompassed within the Board's regulatory review under section 303 of the Riegle Community Development and Regulatory Improvement Act of 1994, Pub. L. 103-325.

Extensive comment was received on the Board's 1995 proposal, including voluminous responses from the major securities trade groups. Commenters generally supported the proposed amendments to Regulation T, but also emphasized the need for more wholesale reform.

Today, the Board is elsewhere adopting as a final rule many of the amendments it proposed in 1995. However, the Board is also proposing additional amendments to Regulation T, and seeking comment on provisions of Regulations G and U as well.<sup>2</sup> In addition, the Board seeks comment on any other steps it can take to reduce the burden imposed by Regulation T, including any steps to reduce the accounting and recordkeeping burdens of the regulation, that would be consistent with the purposes and requirements of the Act.

#### **1. Good Faith Loan Value for all Non-Equity Securities**

Regulation T gives "good faith" loan value to many but not all debt securities. Good faith loan value means that a broker-dealer may extend credit on a particular security in any amount consistent with sound credit judgment. 12 CFR 220.2. Those debt securities not eligible for good faith loan value receive no loan value and therefore have a margin requirement of 100 percent.

With the adoption of today's final rule, the Board currently assigns a debt security good faith loan value if it is: (1) listed on a U.S. securities exchange, (2) a government or municipal security, (3) an investment grade security; or (4) a less-than-investment grade security that is registered with the Securities and Exchange Commission (SEC) and has an original principal amount of not less than \$25,000,000. 12 CFR 220.18(b).

<sup>2</sup> The Board is also continuing to review Regulations G and U as part of its ongoing effort to reduce regulatory burden, as mandated by section 303 of the Riegle Community Development and Regulatory Improvement Act of 1994.

Non-equity securities that are not registered, are not government or municipal securities, and are not investment grade generally will continue to receive no loan value under Regulation T.

In contrast, the Board's Regulations G and U do not impose any margin restrictions on non-broker-dealer lenders (such as banks) when they lend against non-equity securities, even securities that receive no loan value under Regulation T.<sup>3</sup> Foreign broker-dealers and other foreign lenders, with whom U.S. broker dealers increasingly compete worldwide, are generally also unconstrained. Thus, customers who wish to borrow against non-equity securities that receive no loan value under Regulation T, and investors who wish to engage in repo or forward transactions in such securities, may go to these other lenders.

The Board proposes to grant good faith loan value to all non-equity securities. To effectuate this change, the Board is proposing to amend revised section 220.13, discussed below, and section 220.18 (b), (c), and (d) to include all non-equity securities among those securities subject to good faith margin. A new definition of "non-equity security" would be added to section 220.2 to include any security that is not an "equity security" for purposes of section 3(a)(11) of the Act. This definition of non-equity security may include certain equity-linked securities. The Board seeks comment on whether it should modify the definition of non-equity security to exclude equity-linked securities and, if so, what securities should be excluded.

In a conforming change, the definition of "OTC margin bond" in section 220.2 would be deleted; since all non-equity securities would receive loan value, this definition would no longer be required. In another conforming change, the definition of "margin security" in section 220.2 would be revised to include any "non-equity security" instead of any "OTC margin bond."

Expanding the types of non-equity securities eligible for good faith loan value should expand broker-dealers' ability to lend and put them on a more equal footing with other lenders under Regulations G and U. Broker-dealers should be no less competent to determine the loan value of non-investment grade debt securities than a bank or other lender would be. Finally, any remaining regulatory concerns

could be addressed by the self-regulatory organizations (SROs), which include the exchanges and the National Association of Securities Dealers, who still would be able to set their own margin requirements for these transactions.

## 2. Establishment of Non-Equity Account

Other restrictions beyond margin requirements are also currently placed on transactions involving non-equity securities. Currently, any credit extended by a broker-dealer on a non-equity security (other than a security eligible for the government securities account) must be recorded in the margin account. 12 CFR 220.4. These transactions are thus subject to the same restrictions as equity securities with respect to when payments must be made and when positions must be liquidated. On the other hand, because Regulations U and G restrict lending only on equity securities, banks and other lenders may lend on non-equity securities without such Board-imposed restrictions. 12 CFR 221.3(a); 12 CFR 207.3(b).

The Board proposes to allow any transaction involving a non-equity security to be effected in a new "non-equity" account. For example, a customer could effect in this account: (1) purchases of non-equity securities on credit; (2) repurchase and reverse repurchase agreements with broker-dealers on non-equity securities; and (3) the purchase or sale of options on non-equity securities. All transactions in the account would be subject to good faith margin. In order to ensure that unsecured credit would not be extended under the rubric of good faith margin, the proposed rule would prohibit any transaction or withdrawal that would cause the non-equity account to liquidate to a deficit—that is, cause the marked-to-market value of the securities held in the account to be less than the credit outstanding.

This account would be otherwise unregulated. The absence of restrictions on the terms of credit for non-equity securities would promote equality of treatment between broker-dealers and banks and other lenders, who face no Federal Reserve regulation when they lend on non-equity securities.

The Board seeks comment on whether the creation of a non-equity account would be beneficial and whether the account could be better named. The Board also seeks comment on whether this account could be merged with the government securities account (12 CFR 220.6) or the nonsecurities credit account (220.9) or both.

## 3. Portfolio Margining

### A. Amendment to definition of good faith margin

As noted above, Regulation T currently allows good faith margin on some non-equity securities, and the Board is proposing to extend this treatment to all non-equity securities. "Good faith margin" is defined in Regulation T to mean "the amount of margin which a creditor, exercising sound credit judgment, would customarily require for a specified security position and which is established without regard to the customer's other assets or securities positions held in connection with unrelated transactions" (emphasis added). 12 CFR 220.2.

This definition limits so-called "portfolio margining"—allowing positions to be evaluated as a group and determining collateral requirements based upon estimated changes in the value of that portfolio. (It would continue to do so even if the proposed non-equity account were adopted, as the definition of good faith applies regardless of where the transaction is booked.) Regulation T has defined limited positions that can serve as offsets for each other, but any combination of positions not specifically permitted by the regulation may not offset one another. Commenters have for some time requested greater flexibility to engage in cross-margining (allowing positions in financial futures to offset the margin required for a given securities credit) and more broadly in "portfolio" or "risk-based" margining.

In order to remove an impediment to portfolio margining, the Board would amend the definition of "good faith margin" to eliminate the requirement that such margin be calculated "for a specified security position . . . without regard to the customer's other assets or securities positions held in connection with unrelated transactions." Instead, "good faith margin" would be defined to mean "the amount of margin the creditor would require in exercising sound credit judgment."

The Board is seeking comment on whether this definition should: (1) apply only in the proposed non-equity account, thereby continuing to limit portfolio margining of securities eligible for good faith margin in the margin account or market functions account; or (2) apply regardless of the account—margin, non-equity, or market functions—in which the transactions are booked. In addition, the Board seeks comment on the extent to which this change would allow SROs and broker-

<sup>3</sup> Section 7(d) of the Act prohibits the Board from establishing margin requirements on non-equity securities at banks. 15 U.S.C. 78g(d). When Regulation G was adopted in 1968, it was modeled on Regulation U.

dealers greater flexibility to develop portfolio margining systems. The Board also seeks comment from SROs and others on the potential benefits and burdens of adopting a portfolio margining system in addition to the existing position-based system, and whether changing the definition of good faith margin for any or all accounts is consistent with section 7(b) of the Act.

#### B. Separation of Accounts

Section 7 of the Act prohibits a broker-dealer from extending securities credit on any collateral other than a security. Accordingly, Regulation T requires that futures contracts and non-securities be accounted for in their own account, and section 220.3(b) of Regulation T generally prohibits using items in one account (including the nonsecurities account) from being used to meet the margin requirements for items in another account (including the margin account). However, with adoption of today's final rule, Regulation T will allow financial futures to serve in lieu of margin for securities options consistent with SRO rules. This treatment is consistent with Section 7 because the broker-dealer is not extending credit on the futures contract when it considers a futures contract in determining the amount of credit it can extend in good faith on a security.

The proposed rule would amend section 220.3(b) to allow explicitly commodities and foreign exchange positions in the nonsecurities account to be considered in calculating margin for any securities transaction in the proposed non-equity account or the margin account. The Board would expect that these positions would be valued in accordance with SRO rules, where applicable, or in any event not in excess of their marked-to-market value. The proposed rule would also amend section 220.18 to remove a requirement that margin be held for "each security position."

The Board also seeks comment on whether further amendments to sections 220.3(b) should be adopted to facilitate portfolio margining—in particular, whether the Board should modify the general prohibition on separation of accounts in section 220.3(b). Doing so could allow any excess margin in one account to be used to meet a margin deficiency in another account. To the extent that such a change were adopted, the Board seeks comment on the continuing need for a Special Memorandum Account. As noted above, the Board is also seeking comment on whether the government securities account, nonsecurities account, and

proposed non-equity account should be combined.

#### C. Implementation

The Board also seeks comment on any implementation problems that might arise with a partial or complete move to portfolio margining, including the need for delaying the effective date of any final rule in order to allow the SROs time to amend their rules.

#### 4. Borrowing and Lending of Securities by Brokers-dealers

In order to facilitate short sales and the curing of failures to deliver a security (fails), Regulation T allows broker-dealers to borrow and lend securities outside of the normal margin requirements for securities purchases. To qualify for this treatment, borrowing and lending transactions must not only relate to a short sale or fail but also be secured by cash or similarly liquid collateral equal to 100 percent of the value of the securities lent.<sup>4</sup> Any borrowing and lending of securities that does not meet both the "purpose test" and the "collateral test" is usually a financing, is not considered a borrowing and lending of securities for Regulation T purposes, and therefore is conducted in a margin account, subject to the appropriate margin requirement for the underlying security.

Requiring 100 percent collateral (marked to market daily) to secure any stock loan reflects industry practice and is, the Board believes, consistent with prudent securities lending. The SEC imposes similar requirements on the types and amount of collateral a broker-dealer must post when it borrows securities from a customer, and the Department of Labor applies similar requirements to an ERISA pension plan when it lends securities.

Nonetheless, the Board is seeking comment on whether the Board's existing collateral requirements are necessary for Regulation T purposes. Commenters have sought an expansion of eligible collateral to include all securities marginable under Regulation T. Although the Board has expressed concern that Regulation T could be evaded by structuring a financing transaction as a borrowing and lending,<sup>5</sup>

<sup>4</sup> With the adoption of today's final rule, permissible types of collateral include cash, securities issued or guaranteed by the United States or its agencies, certain negotiable bank certificates of deposit and bankers acceptances, and certain irrevocable letters of credit issued by banks, marginable foreign sovereign debt securities, and any collateral acceptable to the SEC when a broker-dealer borrows securities from a customer.

<sup>5</sup> For example, a broker-dealer prohibited by Regulation T from extending a customer 100 percent credit on a security could instead borrow

the purpose test may be adequate to prevent such an evasion. The purpose test limits the exception to transactions that have a clear market purpose that is verifiable (as any evasion becomes evident within a few days, when no short sale is consummated or the fail proves illusory). The collateral test addresses the evasion issue only indirectly by imposing collateral arrangements that conform to industry practice.

Accordingly, the Board is proposing to amend section 220.16 either to allow any security that qualifies for loan value to serve as collateral, valued at its regulatory loan value,<sup>6</sup> or to require a *bona fide* posting of collateral equal to 100 percent of the value of the securities borrowed, without requiring any specific type of collateral. The Board also seeks comment on whether the collateral requirement of section 220.16 could be eliminated altogether. The Board notes that even if the collateral requirements were eliminated, other concerns might merit continued or further regulation by the SROs or the SEC.

#### 5. Extensions of Credit by Foreign Branches of U.S. Broker-Dealers

Most U.S. broker-dealers conduct their overseas operations through separately incorporated subsidiaries of their holding companies. These subsidiaries are not subject to Regulation T or SEC regulations. However, a few firms maintain foreign branches that are subject to Regulation T. The Board is proposing to exclude these foreign branches from Regulation T when they extend credit to foreign persons on foreign securities. This would be analogous to the exclusion from Regulation U of foreign branches of U.S. banks when they extend securities credit.

#### 6. Option as Cover for a Short Sale of an Equity Security

In a short sale, a customer generally sells securities it does not own and borrows those securities from a broker-dealer in order to meet its delivery obligation. The customer is then obligated to redeliver such securities to the broker-dealer at some time in the future, but hopes to obtain those securities for less than the sale price less financing costs. Regulation T currently

the security from the customer and post 100 percent cash collateral; the customer could then withdraw the cash, evading the 50 percent initial or good faith margin requirement.

<sup>6</sup> If this option were adopted, "loan value" would be defined in Regulation T to mean an amount equal to "1 minus the margin requirement for the security under this part."

requires margin of 150 percent for a short sale of an equity security.<sup>7</sup> For example, if a customer sells short 100 shares of XYZ Corp, the broker-dealer retains 100 percent of the proceeds from the sale in the customer's account, and the customer is required to post an additional 50 percent of the sale price. (This parallels the 50 percent margin requirement for a purchase of the stock; in each case, the customer's stake in the transaction must be 50 percent of its price.) However, Regulation T requires margin of only 100 percent—in other words, allows retaining of the proceeds of the sale to suffice—if a "security exchangeable or convertible \* \* \* into the security sold short" is held in the customer's account. The most common example of such a security is a convertible bond.

Although it can be argued that both stock warrants and call options qualify as a "security exchangeable or convertible into another security," the Board has only permitted the former to serve in lieu of the additional 50 percent margin for short sales in Regulation T. See Board Interpretation 12 CFR 220.126, reprinted in the *Federal Reserve Regulatory Service* at 5-488. Some commenters have criticized this inequality of treatment, and some have asked that a call option—in the above example, a call option for 100 shares of XYZ stock—be allowed to serve in lieu of the additional 50 percent margin requirement.

The Board is seeking comment on whether to allow the use of a call option to offset the short sale of a security and whether doing so would bias the market in favor of short selling. The Board has historically sought to ensure that traders on the short side of the market should not be in a position, with a given amount of funds, to exert greater influence on the market than they could with the same amount of funds if they were trading on the long side. However, under this proposal, a customer wishing to purchase 100 shares of XYZ would be required to come up with 50 percent of the purchase price, but a customer wishing to sell 100 shares of XYZ short would only be required to come up with the premium necessary to purchase a call option for 100 shares of XYZ, a far smaller amount. The Board seeks comment on whether this fact argues against adoption of the proposed change.

<sup>7</sup> If a marginable debt security is sold short, the margin required is 100 percent of the current market value of the security plus the margin required by the creditor in good faith.

## 7. Eligibility of Equity Securities for Credit Under Regulations G, T, and U

In order to qualify for credit under Regulation T, an equity security must be a mutual fund, a bond convertible into a qualifying equity security, or registered on a national securities exchange, trade in NASDAQ's National Market System, or appear on the Board's quarterly lists of "marginable OTC stocks" or "foreign margin stocks." Stocks qualify for inclusion on the Board's lists if they meet Regulation T's definition of "OTC margin stock" or "foreign margin stock."

### A. Foreign Margin Stocks Under Regulation T

The Board is adopting as a final rule an amendment to Regulation T that includes as a foreign margin stock any foreign stock that has a "ready market" for purposes of the SEC's net capital rule. 17 CFR 240.15c3-1(c)(11)(i). SEC staff has stated that they will take no action against broker-dealers that treat any foreign stock listed on the Financial Times-Actuaries World Indices as having a ready market for purposes of computing a broker-dealer's net capital. Thus, these stocks will be added to the Board's foreign list.

Although there is considerable overlap between the stocks on the Financial Times Indices and the Board's list of foreign margin stocks, the Financial Times list contains substantially more foreign stocks than the Board's list, and there are also a significant number of foreign stocks that appear on the Board's list but not the Financial Times list. The Board did not receive comment on whether its current list of, and test for, foreign margin stocks would continue to be necessary if this new test were adopted. Accordingly, the Board seeks comment on whether it should rely on the ready market test exclusively and phase out the Board's own test and list.

### B. Domestic Margin Stocks

The Board is also seeking comment on whether it should supplement or replace the current criteria for qualification as an OTC margin stock in section 220.17 of Regulation T by allowing a broker-dealer to extend credit on any stock traded on a national securities exchange, quoted on NASDAQ, or otherwise having a "ready market" for purposes of the SEC's net capital rule. In the domestic area, SEC staff has taken the position that a stock has a "ready market" if: (1) three or more market makers quote its prices through the so-called "pink sheets," and (2) the broker-dealer can show the

existence of bona fide inter-dealer trades within five business days before or after the date of valuation that are of sufficient volume to justify a reasonable belief that the price used would support the liquidation of the entire position at or near that price.

This proposal would make 1700 NASDAQ stocks, as many as 5400 stocks quoted on the NASD's electronic bulletin board, and an unknown number of additional "pink sheet" stocks eligible for broker-dealer credit for the first time. Some of these stocks are thinly traded when compared to currently marginable stocks, including those that qualify as OTC margin stocks. The Board seeks comment on whether such stocks should be eligible to serve as collateral for securities credit.

The Board particularly seeks comment on whether an expansion in the number of OTC margin stocks should be made only for purposes of Regulation T, or for purposes of Regulations G and U as well. Although all the Board's margin regulations currently contain a common definition of "OTC margin stock," this common definition does not result in common treatment of all lenders. Under Regulation T, a broker-dealer is prohibited from lending on any domestic stock that does not qualify as an OTC margin stock; conversely, a bank or other lender is *unregulated* by Regulations U and G when it lends on any stock that does not qualify as an OTC margin stock. Thus, qualification of a stock as an OTC margin stock increases its loan value under Regulation T from zero to 50 percent, but subjects it for the first time to coverage by Regulations G and U and thereby decreases its loan value to the extent that banks and other lenders had previously been willing to give the stock loan value of greater than 50 percent. Conversely, disqualification of a stock as an OTC margin stock eliminates its loan value under Regulation T and thereby prevents broker-dealers from lending on it, but eliminates its coverage by Regulations G and U and allows banks and other lenders to lend as much as they deem appropriate.

Thus, using the ready market definition for purposes of Regulations G and U would impose burdens on banks and other lenders. Use of the definition would limit the amount of credit that banks could extend on thousands of additional stocks and would also require banks to obtain a "purpose statement" (FR U-1) whenever they lend more than \$100,000 on those stocks. In addition, it would no longer be possible for the Board to publish a complete "List of Marginable OTC



Stocks" (OTC List), as the stocks that met the SEC's ready market test would be ever changing and outside the Board's control. Banks therefore would be responsible for determining on their own whether a given OTC equity security was subject to Regulation U. The burden imposed on Regulation G lenders would be similar.<sup>8</sup> In addition, the number of lenders potentially covered by Regulation G would expand to include as many as 6600 additional companies to the extent that those companies extended credit to their employees secured with company stock.<sup>9</sup> Although the Board currently alerts companies with OTC margin stock to the possibility of registration under Regulation G, elimination of the OTC list would prevent the Board from continuing this practice.

Accordingly, the Board is seeking comment on possible solutions to the disparate treatment of broker-dealers and other lenders, and the resulting increase in burden for one group whenever burden is reduced for the other. The Board seeks comment on whether it should establish separate regimes for determining coverage by Regulation T on the one hand, and Regulations G and U on the other; for example, any domestic stock that has a ready market for purposes of the SEC's net capital rule might receive loan value under Regulation T, while only domestic stocks that are listed on an exchange might be subject to Regulations G and U.

#### 8. Options Under Regulation U

On December 12, 1995, the Board published proposed amendments to Regulation U, including one that concerned the treatment of exchange-traded options. The proposal mirrored the treatment proposed by the Board for broker-dealers under Regulation T. Specifically, the Board proposed to allow the same 50 percent loan value for long positions in exchange-traded options currently permitted for other exchange-traded equity securities. Because the final rule under Regulation T ties the loan value of these securities to the rules of the exchange authorized to trade the option, the Board is proposing, as a matter of parity between

Regulations T and U, to amend Regulation U so that banks can lend against exchange-traded options to the extent permitted by the rules of the options exchanges. The Board seeks comment on the practicality of requiring banks to comply with rules of SROs of which they are not members.

#### 9. Technical Amendments

The Board is also prescribing technical amendments to Regulation T that are intended to streamline and rationalize the regulation without altering its substance. The Board is proposing to add a definition of "margin equity security," a term currently used but not defined in the regulation. The Board is seeking comment on whether the definition of "covered option transaction" can be shortened to include "any transaction eligible for the cash account under the rules of the registered national securities exchange authorized to trade the option or warrant or the creditor's examining authority in the case of an unregistered option provided that all such rules have been approved or amended by the SEC." This change could not take effect until the provision in the final rule delegating authority over options to the SROs became effective.

#### Regulatory Flexibility Act

The Board has concluded after reviewing the proposed regulation that, if adopted, it would not impose a significant economic hardship on small institutions. The proposal does not necessitate the development of sophisticated recordkeeping or reporting systems by small institutions; nor will small institutions need to seek out the expertise of specialized accountants, lawyers, or managers in order to comply with the regulation. The proposal is designed to reduce the complexity and burden of Regulation T. The Board therefore certifies pursuant to section 605b of the Regulatory Flexibility Act (5 U.S.C. 605b) that the proposal, if adopted, will not have a significantly adverse economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act (5 U.S.C. 601 *et. seq.*).

#### Paperwork Reduction Act

In accordance with section 3506 of the Paperwork Reduction Act of 1995 (44 U.S.C. Ch. 35; 5 CFR 1320 Appendix A.1), the Board reviewed the proposed rule under the authority delegated to the Board by the Office of Management and Budget. Comments on the collections of information should be sent to the Office of Management and Budget, Paperwork Reduction Projects 7100-0001 (or 7100-

0004), Washington, DC 20503, with copies of such comments to be sent to Mary M. McLaughlin, Federal Reserve Board Clearance Officer, Division of Research and Statistics, Mail Stop 97, Board of Governors of the Federal Reserve System, Washington, DC 20551.

The collection of information implications of the proposal to amend this regulation are found in 12 CFR part 220. This information is required to evidence compliance with the requirements of the Securities Exchange Act of 1934 (15 U.S.C. 78g). The respondents are for-profit financial institutions (7100-0001) and public corporations (7100-0004).

#### Implications for Reporting

The proposal to change the definition of "OTC margin stock" by allowing a broker-dealer to extend credit on any stock traded on a national securities exchange, quoted on NASDAQ, or otherwise having a 'ready market' \* \* \* could lead to an increase in the number of respondents for the OTC Margin Stock Report (FR 2048; OMB No. 7100-0004) because of the increase in the number of firms whose stock would be marginable. The burden per response of 0.25 hours would not change. However, if it is decided that the stock of any firm listed on the NASD SmallCap market is automatically marginable, as currently is the case for the stocks of firms listed on the NASD National Market System, the FR 2048 could be eliminated. Currently, the FR 2048 is filed by approximately 75 respondents each quarter. The current annual burden of the FR 2048 is estimated to be 75 hours. Based on an hourly cost of \$20, the annual cost to the public is estimated to be \$1,500.

The Federal Reserve may not conduct or sponsor, and an organization is not required to respond to, an information collection unless it displays a currently valid OMB control number.

Comments are invited on: (a) whether the proposed amendments to this collection of information are necessary for the proper performance of the Federal Reserve's functions; including whether the information has practical utility; (b) the accuracy of the Federal Reserve's estimate of the burden of the proposed information collection, including the cost of compliance; (c) ways to enhance the quality, utility, and clarity of the information to be collected; and (d) ways to minimize the burden of information collection on respondents, including through the use of automated collection techniques or other forms of information technology.

<sup>8</sup> Regulation G does not contain a paperwork exemption for loans of \$100,000 or less, so all loans secured by these new OTC margin stocks would require a "purpose statement" (Form FR G-3).

<sup>9</sup> Companies that extend credit to employees in connection with an employee benefit plan adopted by the company and approved by its stockholders are not subject to the 50 percent requirement normally imposed on loans secured by margin stock. 12 CFR 207.5. However, these companies must register with the Federal Reserve and provide annual reports of their securities credit activities.

**List of Subjects****12 CFR Part 207**

Banks, banking, Credit, Federal Reserve System, Reporting and recordkeeping requirements, Securities.

**12 CFR Parts 220 and 221**

Banks, banking, Bonds, Brokers, Credit, Federal Reserve System, Margin, Margin requirements, Investment companies, Investments, Reporting and recordkeeping requirements, Securities.

For the reasons set out in the preamble, the Board proposes to amend 12 CFR Part 220 as follows:

**PART 220—CREDIT BY BROKERS AND DEALERS (REGULATION T)**

1. The authority citation for Part 220 continues to read as follows:

Authority: 15 U.S.C. 78c, 78g, 78h, 78q, and 78w.

2. Section 220.2 is amended as follows:

a. By adding a new definition of *Margin equity security* in alphabetical order;

b. By revising paragraph (3) in the definition of *Margin security*;

c. By adding a new definition of *Non-equity security* in alphabetical order;

d. By removing the definition of *OTC margin bond*.

The additions and revisions read as follows:

**§ 220.2 Definitions.**

*Margin equity security* means a margin security that is an equity security (as defined in section 3(a)(11) of the Act).

*Margin security* \* \* \*

(3) Any non-equity security;

*Non-equity security* means a security that is not an equity security (as defined in section 3(a)(11) of the Act).

3. Section 220.3(b) is revised to read as follows:

**§ 220.3 General provisions.**

(b) *Separation of accounts*—(1) *In general.* The requirements of one account may not be met by considering items in another account. If withdrawals of cash or securities are permitted under

the regulation, written entries shall be made when cash or securities are used for purposes of meeting requirements in another account.

(2) *Exceptions.* Notwithstanding paragraph (b) (1) of this section—

(i) For purposes of calculating the required margin for a security in the non-equity account or margin account, assets described in § 220.9(a) (1) or (2) may serve in lieu of margin;

(ii) Transfers may be effected between the margin account and the special memorandum account pursuant to §§ 220.4 and 220.5.

4. Section 220.4(b)(1) is revised to read as follows:

**§ 220.4 Margin account.**

(b) *Required margin*—(1) *Applicability.* The required margin for long or short positions in securities is set forth in § 220.18 (the Supplement) and is subject to the following exceptions and special provisions.

5. The text of § 220.13 is redesignated as paragraph (j) of § 220.3, the section heading of § 220.13 is redesignated as the heading of newly designated paragraph (j) of § 220.3, and § 220.13 is removed.

6. New section 220.13 is added to read as follows:

**§ 220.13 Non-equity account.**

(a) *Permissible transactions.* In a non-equity account, a creditor may effect and finance any transaction involving any non-equity security. No transaction or withdrawal shall be allowed if it would cause the account to liquidate to a deficit.

(b) *Required margin.* The required margin for transactions effected in the non-equity account is set forth in § 220.18 (the Supplement).

7. Section 220.16 is amended by revising the second sentence of paragraph (a) and the last sentence of paragraph (b) to read as follows:

**§ 220.16 Borrowing and lending securities.****Option 1 for Paragraph (a)**

(a) \* \* \* Each borrowing shall be secured by a deposit of one or more of the following: cash, cash equivalents, foreign sovereign nonconvertible debt securities that are margin securities, collateral acceptable for borrowings of

securities pursuant to SEC Rule 15c3-3 (17 CFR 240.15c3-3), irrevocable letters of credit issued by a bank insured by the Federal Deposit Insurance Corporation or a foreign bank that has filed an agreement with the Board on Form FR T-1, T-2, or any margin security, valued at its loan value. \* \* \*

**Option 2 for Paragraph (a)**

(a) \* \* \* Each borrowing shall be secured by a *bona fide* deposit of collateral equal to at least 100 percent of the market value of the securities borrowed. \* \* \*

(b) \* \* \* Each borrowing shall be secured by a *bona fide* deposit of collateral equal to at least 100 percent of the market value of the securities borrowed.

8. Section 220.18 is amended by revising the introductory text and paragraphs (b) through (d) to read as follows:

**§ 220.18 Supplement: Margin requirements.**

The required margin for positions held in a margin account shall be as follows:

(b) Exempted security, non-equity security, money market mutual fund, or exempted securities mutual fund: the margin required by the creditor in good faith or the percentage set by the regulatory authority where the trade occurs, whichever is greater.

(c) Short sale of a nonexempted security, except for a non-equity security: 150 percent of the current market value of the security, or 100 percent of the current market value if a security exchangeable or convertible within 90 calendar days without restriction other than the payment of money into the security sold short is held in the account.

(d) Short sale of an exempted security or non-equity security: 100 percent of the current market value of the security plus the margin required by the creditor in good faith.

By order of the Board of Governors of the Federal Reserve System, April 24, 1996.

William W. Wiles,

Secretary of the Board.

[FR Doc. 96-10608 Filed 5-3-96; 8:45 am]

BILLING CODE 6210-01-P

# **EXHIBIT 15**



From: IJOHNS --MAILHUB1

Date and time

96/06/17 12:14:00

From: Indre Johnson at MailHub1 1996/06/17 12:14  
To: Jim Kerkow at IDSVM1, Rockell Metcalf at IDSVM1  
To: Amy Piper @ Amex at NYKNOT01, Eileen Broyles at NYKNOT01  
To: Gregory T Phalin @ AMEX at NYKNOT01  
To: Mark Davis @ AMEX at NYKNOT01, Maryann Ray at NYKNOT01  
To: Mike Bennett @ AMEX at NYKNOT01  
To: Nancy Rosenberg @ AMEX at NYKNOT01, Patty Bixler at NYKNOT01  
To: Rich Lopez @ AMEX at NYKNOT01, Sharon McFadden at NYKNOT01  
cc: Adam Rothschild @ AMEX at NYKNOT01  
Subject: SOC Tech Solutions

## ----- Message Contents -----

Because not everyone was able to make the call last week, and to make tomorrow's 1:00 EDT follow-up call more productive, I have written up the status of some of the solutions we are pursuing below. At the end of this is a list of additional follow-ups needed.

As you read through this, please think of other questions. Also, we will need more follow-up owners for the outstanding issues at the end.

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need more follow-up owners for the outstanding issues at the end.

{Alternatively, is it time to get our requirements written down and have a PDP session --- ie. get all the right parties together for a full requirements planning session??? Maybe we need to determine which alternative we will pursue first, then have a full planning session??? Please think about this.}

Idea:

1. Can we change the p.o. address for remittance processing. The idea here is to set up a separate processing flow for these payments in order to identify and process them quickly. Also, need to confirm that the clock starts ticking once the payment is in our hands (in the mailroom). (Mike Barnett and I will follow up with Vijay Rangineni)

Status, per discussion with Vijay Rangineni in Chicago Remittance Center:

It would be possible to set up a separate po box that would enable us to establish a separate processing flow for these payments: can "babysit" these remittances to ensure they get processed quickly. Would set up one  
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these remittances to ensure they get processed quickly. Would set up one time in the am to pick them up every day - eg 10 am; need to document this procedure clearly (Vijay does not think we need to disclose to the CM as long as we document this exception procedure clearly internally --- currently the CM agreement states that any mail delivered after 12 noon will be processed next day.) Would then process them through for the 1:30 am mainframe deadline --- this is when FinCap is updated.

Per Vijay, about 80% of the remittances are for the exact amount billed, so these payments could process through quickly; we still have an issue with the other 20%, where we don't have specific identification of the investment amount. We could possibly set up a manual exception process for these, where remit clerks would have to look up, call CM, etc. to determine break-out. Issue is doing within 24 hours.

27/2!

2. Is there a 24 hour payment requirement for government card (ie. we need to reimburse the government in 24 hours for expense advances issued to govt employees). The idea here is to see if we can hook into an existing capability. (Greg Phalin is following up on this)

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Status: TBD

3. Can we get around the 24 hour requirement by footnoting as banks do:  
"Any deposit received after 12:00 noon will be credited (invested) the  
next business day." (Mike Bannett will follow up with Rockell Metcalf)

Status, per voice mail from Rockell:

Banks notify that they will "post funds accepted after 3 pm the next  
day." Mostly done within 24 hours; anything that spills over that time  
frame is not as much an issue for the banks --- can get away with this  
procedure because they don't have to deal with the SEC. We do, so it's  
more risky for us. (This was Rockell's initial reaction; would need to  
follow up in more detail.)

4. Will remittance reengineering help us or hurt us in meeting this 24  
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4. Will remittance reengineering help us or hurt us in meeting this 24 hour requirement (ie. will it eliminate the 2 cycle batching process; what will replace it?). (Mike Bannett and I will follow up with Vijay Rangineni)

Status, per Vijay Rangineni:

Will have no impact on our issue, pos or neg. (Remit reeng is focusing on three areas: outsourcing, consolidating processing into Chicago, image processing.)

5. What kind of impact will remittance awareness process have? (Mike Bannett and I will follow up with Vijay Rangineni)

Status, per Vijay Rangineni:

May be able to use remit awareness (RA). RA works as follows: when envelopes are opened, the A/C # and amount paid are punched in and captured; a copy of this receipt file is sent to update customer service screens so that if CM calls, can be told that check was received but is not yet posted to CM's account. This info is also sent to Credit to stop PF1 Alternate PFs PF2 File NOTE PF3 Keep PF4 Erase PF5 Forward Note PF6 Reply PF7 Resend PF8 Print PF9 Help PF10 Next PF11 Previous PF12 Return

not yet posted to CM's account. This info is also sent to Credit to stop the dunning process. Advantage of RA is the speed of capture. For 80% that pay exact amount billed, can send a feed to AEFA for them to invest. Still an issue with the 20%.

6. Could we set up the test with telephone remittance only? Would require customer to phone in and punch in two amts (two ACHs ???): remittance for Card charges and investment sum. This one has the advantage of solving both the 24 hour timing challenge and the requirement to track bill and investment amounts separately. (Adam Rothschild and I will investigate with Bruno Jiminez in Phoenix)

Status, per IJ discussion with Bruno:

This option looks pretty promising. The CM would need to sign up for telephone bill paying (we need access to CM's bank account --- through Express Cash??). The CM would call and voice response system would be set up to prompt him to punch in both amounts --- bill payment and investment amount.

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The Funds Access System (FAS) transfers \$ from CM's bank account (debits the account) to Amex, and credits the CM's A/C #. Can do this one of two ways: ACH is the federal funds clearance system, would normally handle in 24 hours; faster method is a direct transmit. Right now FAS does the transfers only once a day, between 10 pm and midnight, for all transactions phoned in between previous midnight and 10 pm.

To set this up, would need to do following.

Would need to set up direct transmit to send \$ to AEFA and credit CM's investment account as well. Will have timing issue with transactions phoned in between 10 pm and midnight --- would not get processed until the next day's 10 pm to midnight shift: would need to set up a second FAS processing time. CM systems would need to notify that the CM is

eligible for this (ie. this would prompt the investment sum option in the VR script). Script would need to be modified to include the investment prompt.

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More questions:

--- Vijay said special po address is ok from process standpoint, but we need to check with the remittance address set-up procedure. Right now remittance addresses are set by product and zip code range ---- can one be set up based on other criteria, eg. all accounts (across product types) with securities???? (IJ to follow up with Tom Bauer in Chicago Remittance)

--- A product called "Money Manager"? may have had this functionality.... (Mark Davis to pursue with John Hobby).

--- Does money have to actually move, or is it ok for AEFA simply to know that the remittance is in-house for them to make the investment???  
(Mike B to follow up with Maryann Ray in Treasury)

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--- What happens in the case of bounced checks???

--- Can we tap into functionality developed for The Plan or One Check projects ---- these provided for separate account breakouts on the remittance advice. This may allow us to separate out the bill v. investment sum, so that CM could write in. Would reduce the 20% that need exception processing. (IJ to follow up with Ray Sharp in Ft. Lauderdale)

--- Can we use the footnoting procedure (\$ received after X time posted next day); will this work within SEC regulatory environment? (Mike B to pursue further with Rockell)

--- What is the remittance hierarchy --- eg. pay S&T, then card past due, then current amount due, then investment....???? Can this be solved with a TPNS script (but this is where we had problems with Privileged Assets???)? (Amy Piper to follow up on this)

--- Telephone remit: Need to pursue with Bev Barton (Bruno's colleague  
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VIEW THE NOTE

E01

--- Telephone remit: Need to pursue with Bev Barton (Bruno's colleague responsible for new FAS functionality). Also need to look into VR scripting, etc. with Linda Connors in Phoenix.

E N D O F N O T E

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# **EXHIBIT 16**

## VIEW THE NOTE

E01

From: IJOHNS --MAILHUB1

Date and time 96/06/18 14:42:00

From: Indre Johnson at MailHub1 1996/06/18 14:42  
To: Jim Kerkow at IDSVM1, Rockell Metcalf at IDSVM1  
To: Amy Piper @ Amex at NYKNOT01, Eileen Broyles at NYKNOT01  
To: Gregory T Phalin @ AMEX at NYKNOT01  
To: Mark Davis @ AMEX at NYKNOT01, Maryann Ray at NYKNOT01  
To: Mike Bannett @ AMEX at NYKNOT01  
To: Nancy Rosenberg @ AMEX at NYKNOT01, Patty Bixler at NYKNOT01  
To: Rich Lopez @ AMEX at NYKNOT01, Sharon McFadden at NYKNOT01  
cc: Judy Hoffstein @ AMEX at NYKNOT01  
cc: Adam Rothschild @ AMEX at NYKNOT01  
Subject: Status of SOC

## ----- Message Contents -----

Following is a recap of today's conference call regarding technology solutions for Securities on the Card.

## Background --- Requirements Overview:

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A large, handwritten, stylized signature or scribble in black ink, located at the bottom left of the page. It consists of several loops and a long, sweeping horizontal stroke.

SOC requires capability to bill a CM for a set monthly amount for investment purposes. We need to be able to recognize that the investment has been included in the CM's remittance (separate tracking/identification), and send it to an investment vendor (only AEFA mutual funds/variable annuities in short-term) within 24 hours (a regulatory requirement). The clock starts ticking from the point that the remittance is in our hands (ie. in the mailroom at Amex).

Current Status:

The original goal of the team was to take advantage of existing systems capabilities built for Privileged Assets to get a SOC test out with no systems development effort required. When we determined that PA systems would not meet requirements for SOC, we brainstormed to identify other existing systems solutions.

At this point, we have found three potential solutions ---

1. Separate Remittance Processing Stream
2. Leveraging "Remittance Awareness" Capability
3. Telephone Remittance

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## 3. Telephone Remittance

--- but all still have outstanding issues/questions, and only one meets the requirement to identify investment sum remitted (#3). Furthermore, all three would require systems development effort.

## Next Steps:

In summary, we have exhausted our search for ready-made ("Little T") technology solutions. We would need to do some development work for any of the above three, and in order to get this work (or a longer-term technology solution) sized and prioritized, we need to go back into the NPD process and conduct the necessary steps to get through the concept gate. (Note: This may entail doing some research to get a more accurate gauge of customer interest in the product concept, or a larger product concept that would enable customers to earn a % on Card spending that would build their investment balance (eg. Smart Saver Card concept) --- TBD per discussion with Sponsor.)



Before we get back into the NPD process, we agreed that we need to do two things:

1. We need a very clear definition of the 24 hour processing

PF1 Alternate PFs PF2 File NOTE PF3 Keep PF4 Erase PF5 Forward Note  
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1. We need a very clear definition of the 24 hour processing requirement: we need to understand exactly when the clock starts ticking (at time remittance reaches mailroom, or at time we collect from the mailroom for processing????), and whether or not footnoting this procedure to the customer is required (ie. "remittances received after X time will be processed/invested the next day). Without a very clear definition, we cannot design a systems or process solution. Mike Bannett will follow up with Rockell Metcalf.

2. Once we get this answer, we need to set up a meeting with our Sponsor (Norma Arnold /Mark Davis) and Judy Hoffstein to discuss status and next steps and gain consensus on how we should move forward.

Please let me know if I have misrepresented anything. Thanks for all of your time and input. I will get back to you as soon as possible on the next steps.

E N D O F N O T E

PF1 Alternate PFs PF2 File NOTE PF3 Keep PF4 Erase PF5 Forward Note  
PF6 Reply PF7 Resend PF8 Print PF9 Help PF10 Next PF11 Previous PF12 Return

# **EXHIBIT 17**



## VIEW THE NOTE

E01

From: MBANNE02--NYKSHR01

Date and time 96/06/19 10:53:00

From: Mike Barnett at NYKSHR01 1996/06/19 10:53  
To: Indre Johnson at MailHub1, Nancy Rosenberg at MailHub1  
To: Mark Davis at NYKESH01  
cc: Rockell Metcalf at IDSVM1, Jim Jacobs at NYKSOS13  
Subject: SOC: 24 hour requirements

## ----- Message Contents -----

Team,

I just spent 1/2 hour with Rockell. Below is a summary of our conversation.

The 24 hour clock would start ticking when the "mail is placed in our mailbox", not when we choose to pick it up. The clock is not affected by how many times a day we choose to pick up our mail. I also asked about starting the clock the next day if the remittance came in after a certain time. This was based on a question raised during one of our conference calls about the way banks deposit, the same day, checks which come in before a certain hour and deposit the next day, checks that come in after the cutoff. Rockell said that this would not apply

PF1 Alternate PFs PF2 File NOTE PF3 Keep PF4 Erase PF5 Forward Note  
PF6 Reply PF7 Resend PF8 Print PF9 Help PF10 Next PF11 Previous PF12 Return

VB-34

that come in after the cutoff. Rockell said that this would not apply to us because we are not a bank. Banks are not regulated by the SEC. SEC restrictions are tighter than banking regulations.

Rockell also reminded me that the 24 hours is not a cycle time written in stone anywhere. Rather it is Rockell's opinion based on his research and the fact that outside counsel agreed to write an opinion letter to the SEC on our behalf, if we developed a 24 hour process.

I asked Rockell about getting an opinion from the SEC in advance so that we could avoid building something, putting it in the market only to have the SEC say stop. He said we could do this, but cautioned me that there is a higher likelihood that the SEC would say no if we go to them before launching the service. However, if we were to go ahead and build and launch the service and then the SEC questioned the process, we would have a higher probability of being allowed to continue with the service. Clearly, we would need to show that we did our legal homework and can show good reason why we thought this was fully permissible. It's harder to stop a moving train.

Rockell also asked about one of the options we batted around several  
PF1 Alternate PFs PF2 File NOTE PF3 Keep PF4 Erase PF5 Forward Note  
PF6 Reply PF7 Resend PF8 Print PF9 Help PF10 Next PF11 Previous PF12 Return

## VIEW THE NOTE

E01

Rockell also asked about one of the options we batted around several months ago. We had thought about making all of the people and systems who touch the remittance dual employees of TRS and AEFA. This would make them part of the broker dealer and therefore the "24 hour" clock would not apply because the money would be going directly into the broker dealer, not through another corporate entity. If I remember this idea was taken off of the "hot idea list" because it would require sending all remittances to Chicago (MaryAnn had float concerns with this), making these people dual employees of TRS and AEFA and changing the ownership of the related systems and bank accounts (this could open up FINCAP to SEC inspection). This felt big, so we took it off of the list, but it may not actually be as tough or risky as at first glance. This probably merits a good review.

I hope this clarifies the requirements. If you have more questions please feel free to contact me at 3/4306.

Mike B.

END OF NOTE

*It's harder to stop a moving train.*

PF1 Alternate PFs PF2 File NOTE PF3 Keep PF4 Erase PF5 Forward Note  
PF6 Reply PF7 Resend PF8 Print PF9 Help PF10 Next PF11 Previous PF12 Return

# **EXHIBIT 18**

1996

VB-34

**PROJECT APPROACH**

A cross-organizational team made up of key business leaders for each of the deliverables stated in the plan will manage this project.

*Project team roles and responsibilities:*

Role/Name	Responsibilities	Time Commitment
Project Sponsor: Brian Kleinberg	<ul style="list-style-type: none"> <li>Support project leader</li> <li>Champion project across organization and with senior leadership</li> <li>Ensure appropriate resources (people and budget) are available.</li> <li>Maintains and clarifies strategic direction.</li> <li>Approves goals and measures.</li> </ul>	
Project Owner: Nancy Jones	<ul style="list-style-type: none"> <li>Sets high-level project direction.</li> <li>Directly supports project leader.</li> <li>Facilitates communication to broader organization and to project sponsor.</li> <li>Reviews status and project priorities.</li> <li>Shares accountability with project leader for key deliverables.</li> <li>Acts as strong advocate for project throughout organization.</li> </ul>	
Project Leader Joel Allen (interim) Susanne Crane <i>Compton Leung</i>	<ul style="list-style-type: none"> <li>Accountable for overall success of project.</li> <li>Project planning.</li> <li>Project communications to core team, stakeholders, owner, sponsor, and others as needed.</li> <li>Ensures linkage with appropriate areas</li> <li>Manages scope of project.</li> <li>Identifies, addresses and resolves business issues and decisions.</li> <li>Leads and provides work direction to core team on a daily basis.</li> </ul>	
Core Team Members: Additional responsibilities specific to the team member's expertise will be listed with his or her name.	<ul style="list-style-type: none"> <li>Represent respective business area</li> <li>Completion of tasks agreed to in project plan</li> <li>Identifies and resolves issues</li> <li>Time and commitment (team meetings and time to complete specific tasks)</li> <li>Accountable for reporting status of efforts to project leader</li> <li>Accountable for success of project implementation.</li> </ul>	

Core Team Member:	Responsibilities	
Legal Rockell Metcalf <i>Shirley Beck</i>	<ul style="list-style-type: none"> <li>Provides legal counsel</li> <li>Leads effort to achieve SEC/other regulatory approval</li> <li>Identifies and resolves legal issues</li> <li>Provides exact guidelines for development of capability</li> </ul>	
FD Marketing/ PASA Anne Bertelsen	<ul style="list-style-type: none"> <li>Develops appropriate marketing plans for test market</li> <li>Provides business requirements to meet marketing needs</li> <li>Implements marketing plan</li> <li>Participates in definition of requirements and evaluation of test market</li> <li>Coordinates with other marketing efforts</li> </ul>	
FD Marketing/ Funds Ed Hrybenko	<ul style="list-style-type: none"> <li>Develops appropriate marketing plans for test market</li> <li>Provides business requirements to meet marketing needs</li> <li>Implements marketing plan</li> <li>Participates in definition of requirements and evaluation of test market</li> <li>Coordinates with other marketing efforts</li> </ul>	
Business Project Manager Joan Prairie	<ul style="list-style-type: none"> <li>Develops project plan</li> <li>Manages scope and change control</li> <li>Ensures business requirements are complete and clearly understood.</li> <li>Coordinates technology and services aspects of project.</li> </ul>	
CSO Marcus Sheire	<ul style="list-style-type: none"> <li>Scope out and document issues relating to CSO operational activities for the Investing on the Card market test.</li> <li>Provide project lead and project team with updates of CSO operational issues.</li> <li>Raise known issues relating to other areas of the company outside of the CSO.</li> <li>Leads development of service related components including staffing, training, process flow, etc.</li> </ul>	
Technology Leader Patrick Reineke	<ul style="list-style-type: none"> <li>Ensures technology is in place to support a successful test.</li> <li>Ensures prioritization within technologies and manage technology resources.</li> <li>Leads resolution of technology issues.</li> </ul>	

FD Technologies Liaison Nik Muzumdar	<ul style="list-style-type: none"> <li>Acts as project liaison to Card Technologies areas.</li> <li>Works with AEFA (AESS &amp; Vantage) Technologies in requirement definition</li> <li>Ensures that business requirements are communicated to Card Technologies.</li> <li>Monitors and reports progress, and helps coordinate work effort between Card and AEFA Technologies.</li> </ul>	
AEFA/Variable Annuities Sarah Mealey	<ul style="list-style-type: none"> <li>Represents product related issues.</li> <li>Ensures Variable Assets systems support for PASA inclusion.</li> </ul>	
Finance	<ul style="list-style-type: none"> <li>Conducts economic analysis.</li> <li>Develops CBA.</li> <li>Develops metrics and tracks results in conjunction with marketing and project leader.</li> </ul>	
Content Expert/ Jeff Hovis	<ul style="list-style-type: none"> <li>Reviews business model, systems designs, money flow models.</li> <li>Identifies issues and makes recommendations for resolution.</li> </ul>	
CCSG NPD	<ul style="list-style-type: none"> <li>Identifies relevant linkages to CCSG.</li> <li>Coordinates efforts with CCSG.</li> </ul>	

#### Key Stakeholders:

- Sue Skalicky
- Cindy Carlson
- Leslie Bodell
- Rich Sykes
- John Sweeney
- Al Treece
- Sandy Deming

*John Cutler*  
*Pam*

#### Project decision controls:

- Project Sponsor approves strategic direction.
- Project Owner approves budget, resources, and proposed business model.
- Major changes to project must be approved by project sponsor or project owner.
- Project Leader runs the project as the decision-maker once implementation plan is approved and brings unresolved issues to the Project Owner.

#### ESTIMATED COST

Estimate of \$500,000. Cost will be re-estimated when the PDR is complete.

#### RISKS

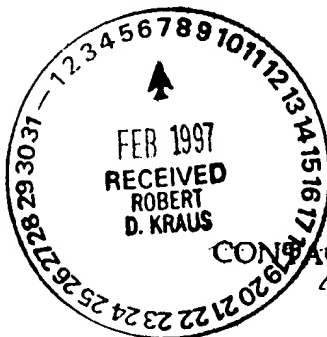
- The SEC may not give approval on either issue they will address.
- Once the case is presented, the timing of the SEC ruling is not controllable.

# **EXHIBIT 19**



**Lee & Associates, Inc. PUBLIC RELATIONS**

145 SOUTH FAIRFAX AVE., SUITE 301 • LOS ANGELES, CA 90036 • Tel: (213) 938-3300 • Fax: (213) 938-3305 • E-mail: leep@ool.com

**NEWS!**FOR IMMEDIATE RELEASE  
February 6, 1997

Steve Norman  
Dory Daniels

Is this possible?  
See page 2. Please let me know  
Harold Gallagher  
Directional Robotics  
(209) 435-8211  
ASAP &  
/can 10/1.

OR

Howard Pearlstein  
Lee & Associates, Inc.  
(213) 938-3300

TD: Bob Kraus -  
see p. 2 - is this  
possible? DHD

**TERMINATOR SIGHTED NEAR INTERNET SECURITIES WEBSITE:  
ANNIHILATION OF THE DULL AND BORING  
IPO PROSPECTUS PRESUMED IMMINENT**

Fresno, CA -- (February 6, 1997) -- Using a combination of multimedia, multi-language technologies never before seen in the history of the securities industry, Directional Robotics unveils its \$5 million Initial Public Offering over the Worldwide Web with an on-line prospectus featuring animation, sound effects, video clips, and colorful graphic images and photographs. Prospectus text is available in English, Spanish, German, and Japanese. The result is a presentation that adheres to Securities and Exchange Commission guidelines yet tells its story in an easily understandable, likewise provocative format that will engage the interest of professionals and first-time investors alike.

As Harold J. Gallagher, President and CEO of Directional Robotics, Inc., puts it, "A standard paper prospectus is typically very dry commentary. With our colorful, active on-line prospectus, investors can literally see what our company - with its management and technology - is all about. While our above reference to the demise of unimaginative documents is made somewhat tongue-in-cheek, there's no question that lively, interactive, and accurate presentations of securities offerings on the Internet are bound to grow in preference in the near future - particularly with non-professional, first-time investors who may be intimidated by the historically solemn appearance of formal securities documents."

(MORE...)

By Hand  
TO: Rockell Metcalfe  
This came up on Friday (2/7).  
Susan Miller of Public Affairs  
called me - I told her Amer  
is not prepared (yet) to allow  
securities to be purchased on  
the Card. Please  
follow up with her.  
Thanks! Bob K

Directional Robotics  
February 1997  
Page 2

Directional Robotics, Inc., a development-stage company targeting the electro-optical navigation and orientation markets, believes its innovative website (<http://www.directional.com>) supports the SEC's mission to broaden the scope of America's corporate shareholder base to include those outside of the "traditional" investment community. "There's no question this is what the Information Superhighway is all about," Gallagher adds, "opening doors to knowledge and opportunities that were, until now, beyond the reach of the general public."

Other unique aspects of this cyber-venture: Directional Robotics is the first company to offer its shares on the Internet simultaneously in all 50 states and the first to offer stock purchase by using any of the three major credit cards, including Visa, MasterCard, and-- for the first time ever-- American Express.

Making navigation around the website easy even for newcomers, Directional Robotics' website has key section headings located in a separate frame to the left of the main window, which allow the viewer to visit any of the four major categories of information by easily clicking on those buttons, or on hypertext links sprinkled liberally throughout the site.

Major sections cover the company, including a video and audio message from Gallagher; on-line photos and resumes of key management, directors, and even consultants; technology, including abstracts of the company's five U.S. patents awarded for proprietary technology; products, including animated simulations of planned products as the engineers envision them-- in action!; and the Initial Public Stock Offering, including the ability to electronically initiate actual stock purchases using an interactive, on-line form. (Paper filings are available to investors and all electronic transactions are subsequently confirmed.)

Directional Robotics corporate headquarters are located at 5610 N. Palm Avenue, Fresno, California 93704, 1-800-99-ROBOT. The company's Internet address is: <http://www.directional.com>.

This announcement is neither an offer to sell nor a solicitation of an offer to buy any of the securities described in the company's prospectus. An offer to sell Directional Robotics' securities is made only by the company's prospectus.

###



JAN-30-1997 11:46

213 938 3585 LEE &amp; ASSOCIATES

82

209+435+3743 P.03

504 211 102 1

TRAVEL RELATED SERVICES COMPANY, INC.

P. O. Box 53852

Phoenix, Arizona 85072-3852

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Please call 1-800-528-2121 for authorization of all charges over your floor limit.

PAGE 1 OF 1

PAYMENT DATE: 01/27/97

DRAFT NUMBER: 95417819

DRAFT RECONCILIATION SUMMARY				
	GROSS AMOUNT	DISCOUNT AMOUNT	OPTIMA <sup>SM</sup> DIVIDEND	NET AMOUNT
OPENING DEBIT BALANCE				\$21.55
TOTAL SUBMISSIONS Reference #: 000032	\$300.00	\$8.85	\$ .00	\$291.15
TOTAL PAYMENT	\$300.00	\$8.85	\$ .00	\$269.59

Discount Rate:	2.95%	OPTIMA <sup>SM</sup> Dividend Rate:	0.00%	OPTIMA <sup>SM</sup> Gross Amount:	\$ .00
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DETACH HERE

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RELATED  
SERVICES

American Express  
Travel Related Services Company, Inc.  
2423 East Lincoln Drive  
Phoenix, Arizona 85016

PAYEE NUMBER  
504 211 102 1DATE  
01/27/97DRAFT NUMBER  
9541781953-91  
670

PAY TWO HUNDRED SIXTY-NINE AND 60/100 DOLLARS

PAY TO  
THE ORDER  
OF

DIRECTIONAL ROBOTICS INC  
5810 N PALM AVE  
FRESNO CA 93704-1825

VOID IF NOT PRESENTED IN 90 DAYS

\$269.60

TO: Bob (bray)  
More stuff in  
two post office

Walter L. Bernier  
AUTHORIZED SIGNATURE

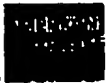
PAYABLE THROUGH  
FIRST UNION NATIONAL BANK OF FLORIDA  
FT. LAUDERDALE, FLORIDA 33305

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TOTAL P.03

JAN-30-1997 11:46

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RELATED  
SERVICES**

An American Express Company

504 211 102.1

209+435+3743 P.03

TRAVEL RELATED SERVICES COMPANY, INC.

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Phoenix, Arizona 85072-3852

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Please call 1-800-528-2121 for authorization of all charges over your floor limit.

PAGE 1 OF 1

PAYMENT DATE: 01/27/97

DRAFT NUMBER: 95417819

**DRAFT RECONCILIATION SUMMARY**

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OPENING DEBIT BALANCE				\$21.55-
TOTAL SUBMISSIONS Reference #: 000032	\$300.00	\$8.85	\$0.00	\$291.15
TOTAL PAYMENT	\$300.00	\$8.85	\$0.00	\$269.60

Discount Rate: 2.95%	OPTIMA <sup>SM</sup> Dividend Rate: 0.00%	OPTIMA <sup>SM</sup> Gross Amount: \$0.00
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American Express  
Travel Related Services Company, Inc.  
2423 East Lincoln Drive  
Phoenix, Arizona 85016

PAYEE NUMBER  
504 211 102.1DATE  
01/27/97DRAFT NUMBER  
9541781963-211  
670

PAY TWO HUNDRED SIXTY-NINE AND 60/100 DOLLARS

PAY TO  
THE ORDER  
OF

DIRECTIONAL ROBOTICS INC  
5810 N PALM AVE  
FRESNO CA 93704-1825

VOID IF NOT PRESENTED IN 90 DAYS

\$269.60

PAYABLE THROUGH  
FIRST UNION NATIONAL BANK OF FLORIDA  
FT. LAUDERDALE, FLORIDA 33305

*Walter L. Bern...*  
AUTHORIZED SIGNATURE

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TOTAL P.03

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TRAVEL RELATED SERVICES Company, Inc.  
P. O. Box 53852  
Phoenix, Arizona 85072-3852



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Please call 1-800-528-2121 for authorization of all charges over your floor limit.

PAGE 1 OF 1

PAYMENT DATE: 01/27/97

DRAFT NUMBER: 95417819

DRAFT RECONCILIATION SUMMARY				
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OPENING DEBIT BALANCE				\$21.55
TOTAL SUBMISSIONS Reference #: 000032	\$300.00	\$8.85	\$ .00	\$291.15
TOTAL PAYMENT	\$300.00	\$8.85	\$ .00	\$269.60

Discount Rate: 2.95%	OPTIMA <sup>SM</sup> Dividend Rate: 0.00%	OPTIMA <sup>SM</sup> Gross Amount: \$ .00
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American Express  
Travel Related Services Company, Inc.  
2423 East Lincoln Drive  
Phoenix, Arizona 85016

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504 211 102 1DATE  
01/27/97DRAFT NUMBER  
954178195341  
670

PAY TWO HUNDRED SIXTY-NINE AND 60/100 DOLLARS

PAY TO  
THE ORDER  
OF

DIRECTIONAL ROBOTICS INC  
5510 N PALM AVE  
FRESNO CA 93704-1828

VOID IF NOT PRESENTED IN 90 DAYS

\$269.60

PAYABLE THROUGH  
FIRST UNION NATIONAL BANK OF FLORIDA  
FT. LAUDERDALE, FLORIDA 33305

Walter L. Bernier  
AUTHORIZED SIGNATURE

⑈95417819⑈ ⑆067006173⑆ 111 0296 9⑈5790

TOTAL P.03

JAN-30-1997 11:46

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 P. O. Box 53852  
 Phoenix, Arizona 85072-3852

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PAGE 1 OF 1

PAYMENT DATE: 01/27/97

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Discount Rate: 2.95%	OPTIMA <sup>SM</sup> Dividend Rate: 0.00%	OPTIMA <sup>SM</sup> Gross Amount: \$ .00
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**TRAVEL  
RELATED  
SERVICES**

American Express  
 Travel Related Services Company, Inc.  
 2423 East Lincoln Drive  
 Phoenix, Arizona 85016

PAYEE NUMBER  
 504 211 102 1

DATE  
 01/27/97

DRAFT NUMBER  
 95417819

63-91  
 670

PAY TWO HUNDRED SIXTY-NINE AND 60/100 DOLLARS

PAY TO  
 THE ORDER  
 OF

DIRECTIONAL ROBOTICS INC  
 8810 N PALM AVE  
 FRESNO CA 93704-1828

VOID IF NOT CANCELLED IN 90 DAYS

AMOUNT  
 \$269.60

PAYABLE THROUGH  
 FIRST UNION NATIONAL BANK OF FLORIDA  
 FT. LAUDERDALE, FLORIDA 33306

*Walter L. Bern...*  
 AUTHORIZED SIGNATURE

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TOTAL P.03

JAN-30-1997 11:46

209+435+3743 P.03

504 211 102 1

TRAVEL RELATED SERVICES COMPANY, INC.

P.O. Box 53852

Phoenix, Arizona 85072-3852

TRAVEL  
RELATED  
SERVICES

An American Express Company

For questions regarding your account call 1-800-528-5200

Remember that all American Express Card numbers begin with "37" or "34".  
Please call 1-800-528-2121 for authorization of all charges over your floor limit.

PAGE 1 OF 1

PAYMENT DATE: 01/27/97

DRAFT NUMBER: 95417819

## DRAFT RECONCILIATION SUMMARY

	GROSS AMOUNT	DISCOUNT AMOUNT	OPTIMA <sup>SM</sup> DIVIDEND	NET AMOUNT
OPENING DEBIT BALANCE				\$21.55
TOTAL SUBMISSIONS Reference #: 000032	\$300.00	\$8.85	\$ .00	\$291.15
TOTAL PAYMENT	\$300.00	\$8.85	\$ .00	\$269.60

Discount Rate: 2.95% OPTIMA<sup>SM</sup> Dividend Rate: 0.00% OPTIMA<sup>SM</sup> Gross Amount: \$ .00

DETACH HERE

TRAVEL  
RELATED  
SERVICES

American Express  
Travel Related Services Company, Inc.  
2423 East Lincoln Drive  
Phoenix, Arizona 85016

PAYEE NUMBER  
504 211 102 1DATE  
01/27/97DRAFT NUMBER  
95417819

670

PAY TWO HUNDRED SIXTY-NINE AND 60/100 DOLLARS

PAY TO  
THE ORDER  
OF

DIRECTIONAL ROBOTICS INC  
5810 N PALM AVE  
FRESNO CA 93704-1828

VOID IF NOT PRESENTED IN 90 DAYS

AMOUNT  
\$269.60

PAYABLE THROUGH  
FIRST UNION NATIONAL BANK OF FLORIDA  
FT. LAUDERDALE, FLORIDA 33605

Walter L. Bernier  
AUTHORIZED SIGNATURE

95417819 0067006173 111 0296 905790

TOTAL P.03

# **EXHIBIT 20**





VB-34

**Memorandum**

Date July 23, 1997

City New York

Office General Counsel's Office

Subject **PURCHASING SECURITIES WITH CREDIT CARD**

To Rockell Metcalf  
John Hobby  
cc: Tim Heine  
Gail Fine

From Robert D. Kraus  
Group Counsel

A handwritten signature in black ink, appearing to be "R. Kraus", written over the printed name of Robert D. Kraus.

Attached for your information is a Fed staff opinion announcing the view that credit cards may be used to purchase securities, based on a 1996 amendment to Regulation T. Note that this opinion does not distinguish the situation where the credit card issuer is affiliated with the broker/dealer.

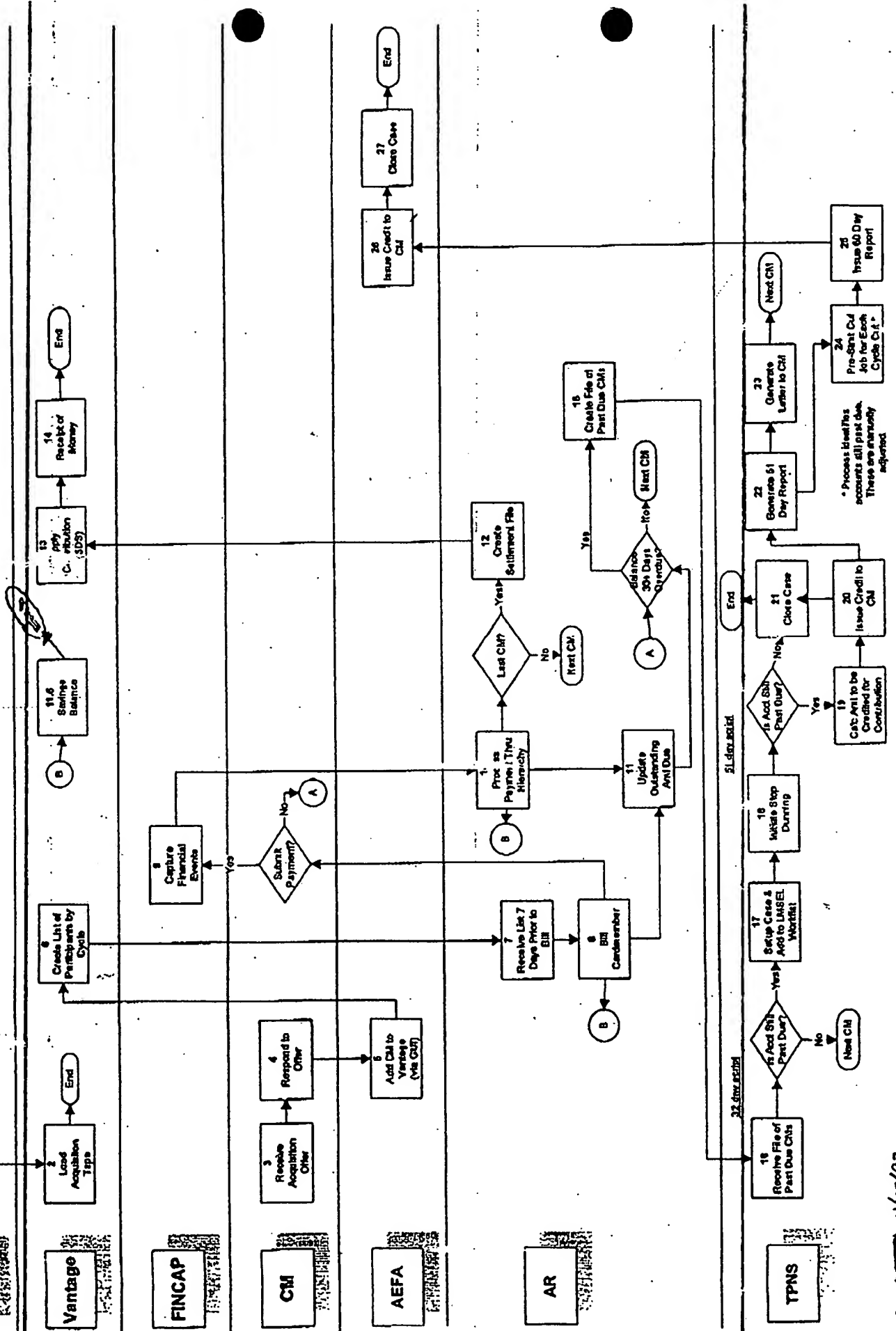
# **EXHIBIT 21**

# Private Assets Functionality Current RCP Remittances & Settlement Process

P. 02

FAX NO. 6126713866

NOV-25-97 TUE 17:21



Rev. 10: 11/17/97

# **EXHIBIT 22**

VB-34



Investing on the Card

December 15, 1997

## Agenda

---

*Earlier this year, AEFD -- in partnership with TRS and AEFA technologies -- launched an initiative to facilitate purchasing securities with the Amex Card.*

*The purpose of our meeting today is to share Investing on the Card objectives and progress.*

*For our discussion, we will cover:*

- Regulatory background
- Initiative Objectives and Scope
- Operational Overview
- Next steps

## **Background**

---

*Historically, regulatory restrictions have prevented Amex from developing the capability to offer cardmembers the opportunity to purchase securities with their card. Specifically, Amex -- like most other card issuers -- was hindered by several regulatory constraints:*

- Prohibition against non-registered companies both offering security products or accepting funds for securities
- Prohibition against utilizing loaned monies to purchase securities
- Requirement to provide next computed price after receipt of order
- Regulation Z which gives cardmembers right to assert claims against card issuers for faulty products and/or services

## **Background cont.**

---

*Last year, two new regulatory developments opened the way for Amex to re-assess the feasibility of offering card billing*

- The Federal Reserve Board ruled that broker-dealers could allow customers to purchase securities on credit
- The Securities and Exchange Commission hinted that they would re-evaluate their stance in light of the Federal Reserve Board's ruling -- if an acceptable process could be proposed



## Initiative Objective and Scope

---

*With cautious confidence that the SEC would grant us permission to proceed, AEFD initiated Investing on the Card with the following objective and scope:*

- Objective: Build functionality to allow cardmembers to make security purchases on their American Express Card
  - (b) Initially replicating direct debit dollar cost averaging capabilities
- Scope: Card billing feature will be built for all current and potential AEFD financial products -- mutual funds, annuities, equities, certificates, bonds, proprietary and non-proprietary, load and no-load, etc.
- Initially, the functionality will be limited to charge cardmembers
  - 9MM consumer customers including 300,000 Platinum and over 1MM membership reward enrollees
  - 1.5MM SBS customers
- Lending Products will be incorporated with the release of Triumph functionality in 1999

## Requirements

*To realize our vision for Investing on the Card, the following milestones are critical*

- Favorable ruling from the SEC that permits TRS to provide card billing for security purchases
- Technological changes to both TRS and AEFA systems
  - Fairly minor changes to TRS' Legacy System but significant for Triumph
    - > Legacy: Create new SE codes for each product
    - > Triumph: Changes to payment hierarchy and credit/dunning processes
  - Programming and linkage changes to AEFA systems
    - > New routines need to be written -- e.g., enlisting in funds/products, allocation instructions, execution orders (see Appendix B for process map)
    - > Linkages are required between annuity and brokerage product systems
    - > Card billing, remittance and reconciliation processes need to be modified
- Identification and/or development of appropriate marketing opportunities for leveraging Investing on the Card functionality
  - Historical performance indicates 50% response ratelift due to card billing functionality

*Note*



## **Progress To-date**

---

*AEFD Legal and Technologies have taken the lead in preparing the regulatory and technology solutions to enable card billing functionality 2Q98.*

- Legal request for SEC will be ready by late next week
- Technologies has conducted a high level assessment
  - More formal business requirement definition and sizing to be completed in February
  - Development to begin in March
- High Level Business Case to prioritize and resource initiative to be completed this week

*Now, AEFD Marketing needs to begin identifying products and positioning to leverage this capability*

- Possible opportunities include IRA, PASA and trading lines
- Positioning should leverage convenience, flexibility discipline and no pre-set spending limit

## Operational Overview

---

*Initially, Investing on the Card processes will mimic those currently utilized by Privileged Assets*

- Customers enroll in Privileged Assets, indicating on their application their annuity contribution commitment
  - Contributions are voluntary and appear on the cardmember's statement -- monthly, quarterly or annually -- depending upon their preference
  - Because contributions are voluntary, non-payments cannot trigger dunning process, impact credit rating or open to buy
- When payment is received, AEFA is notified and process for same day settlement is initiated (see Appendix A for detailed process map)
  - Non-payments exceeding 60 days are dropped from the statementing process
- AEFA receives funds via electronic wire transfer from TRS no later than 48 hours after payment

need to try for 24 hrs.

## Next Steps

*We are moving rapidly toward our goal.*

### Task

High Level Business Case written and submitted

\* \*

Legal Issues resolved and proposal submitted

\* \*

SEC Response

late Feb

Business requirements defined

Early Feb

Programming begins

March

Test

Early May

Full Functionality

June

# Private Assets Functionality Current RCP Remittances & Settlement Process

CIM

Vantage

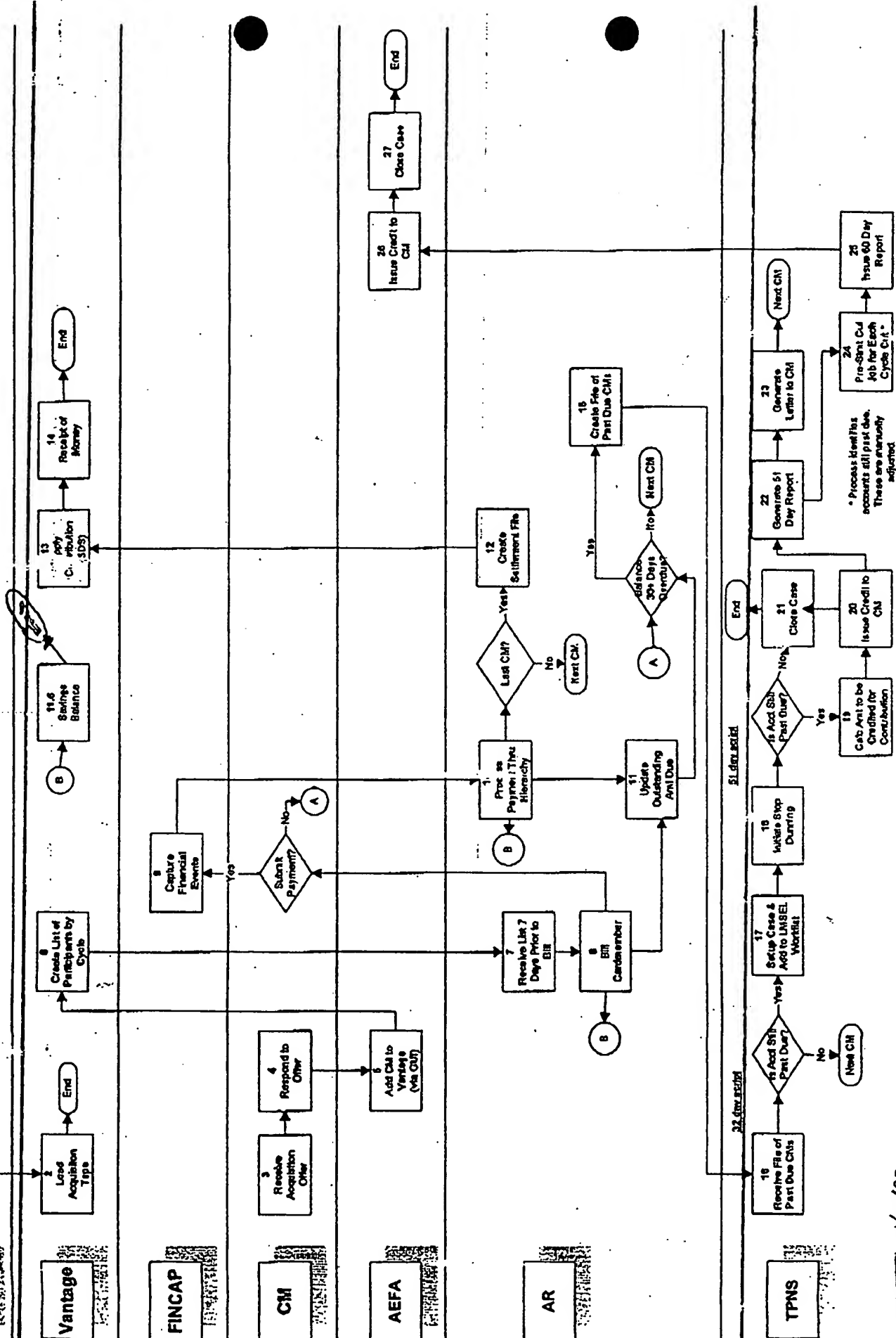
FINCAP

CM

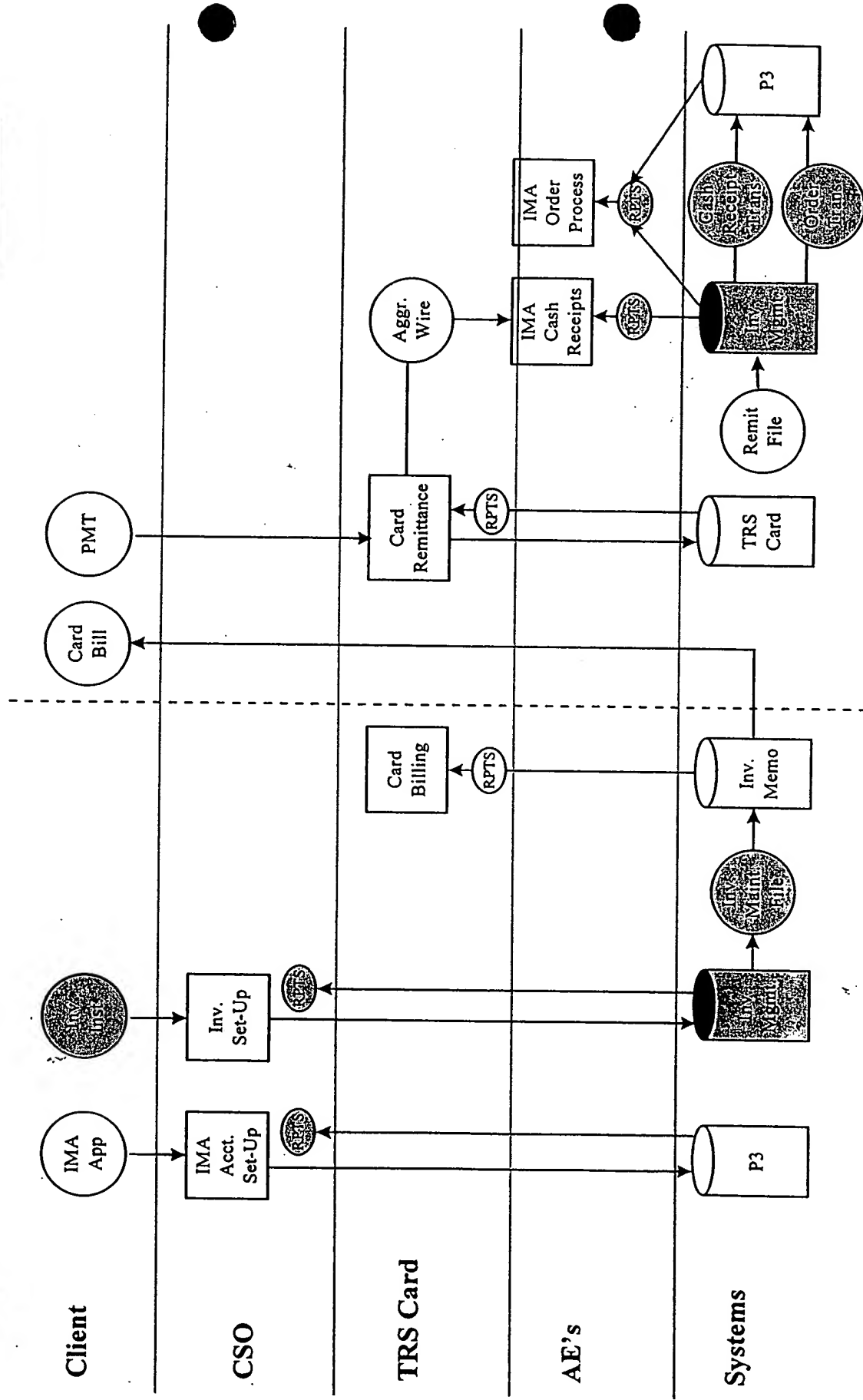
AEFA

AR

TPNS



# Appendix B



# **EXHIBIT 23**



John - FYI  
John



Investing on the Card  
Assessment Update

December 15, 1997

# Agenda

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*Our goal today is to provide an update of our progress assessing the feasibility of obtaining Legacy system functionality for Investing on the Card® in 1998.*

*In addition, we will need direction from you on a number of outstanding issues.*

*For our discussion, we will cover:*

- Background
- Findings to-date
- Outstanding issues
- Next steps

# Background

*A key growth objective for AEFD is to obtain card billing functionality for Investing on the Card.®*

*Due to Triumph migration, changes to legacy system have to be "minor" -- therefore goal is to mimic functionality which currently exists for Privileged Assets, our fixed annuity.*

- Contributions to the annuity are voluntary and appear on the cardmember's statement -- monthly, quarterly or annually, depending on cardmember's preference
- Because contributions are voluntary, contributions are treated differently in the ARS, TPNS and Risk systems
  - Amounts cannot impact CM's open to buy
  - Non-payments cannot trigger dunning process or impact credit rating
- Non-payments exceeding 60 days are dropped from the statementing process
- Monthly billing files are sent from AEFA to TRS
- Upon payment receipt, AEFA is notified and process for same day settlement is initiated (see Appendix A for detailed process map)
- AEFA receives electronic wire transfer from TRS no later than 48 hours after payment, however CM's annuity policy is credited on date of payment

# Findings To-Date

## *Functionality to enable Investing on the Card is highly feasible in early 1998.*

- Legacy systems require minor modifications to replicate current Privileged Assets routines for other products such as mutual funds, IRA, PASA
  - Additional SE numbers will be required -- unique number drives billing notation
  - Enlist programming will require modifications to acknowledge AEFD product SE numbers
  - ARS tables will have to be updated for new SE numbers
  - Risk requires no major system work as process is currently manual
  - TPNS -- which triggers dunning process development time -- will need to be updated. This will encompass the bulk of the work required on the Legacy systems side.
  - Currently projections indicate 4 months "beginning to end" -- potentially less
- AEFA systems require both minor modifications as well as new functionality
  - New routines need to be written e.g., enlisting in funds/products, allocation instructions, execution orders (see Appendix B for process map)
  - Linkages are required between annuity product systems and security product systems
  - Card billing, remittance and reconciliation processes can be modified
- Legacy and AEFA systems development activities can occur in parallel, bringing project estimate deliverable date to April 1, 1998
- Cost estimates for AEFA systems is projected to be between \$100,000 - \$200,000; cost estimates for Legacy TBD

# Outstanding Issues

*While conceptually, Investing on the Card can be made available by April 1st, a number of issues have been raised which could impact the design -- and therefore delivery date. Specifically:*

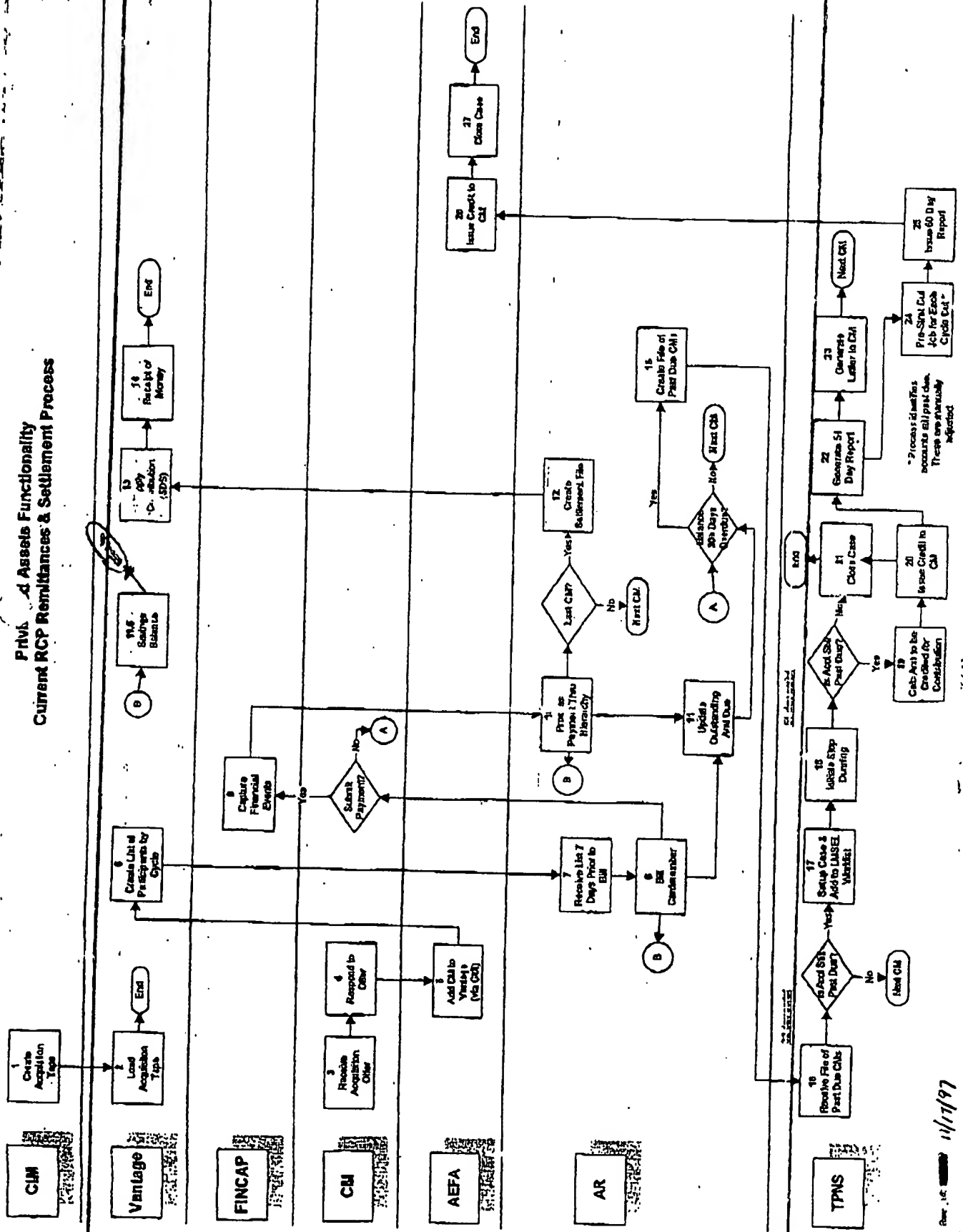
- What products and how many will we offer card billing?
  - Type Strategist? Equities? Loaded funds?
  - Volume of products will complicate the billing, maintenance, accounting and reconciliation requirements
  - Channel: should products available through advisors be included as well?
- What is the economic impact of card billing for the product?
  - Non-proprietary vs. proprietary
  - SE discount fees have not been factored into any of the product financials. PA currently pays between .5%-2.5% depending on the policy's issuer
- Are there potentially some legal requirements that need to be built in?
  - For instance, 24-hour vs. 48-hour settlement?

## Next Steps

*In order to meet our April 1st delivery date, there are a number of critical immediate next steps. Your support will be required to ensure Legacy and AEFA systems prioritization.*

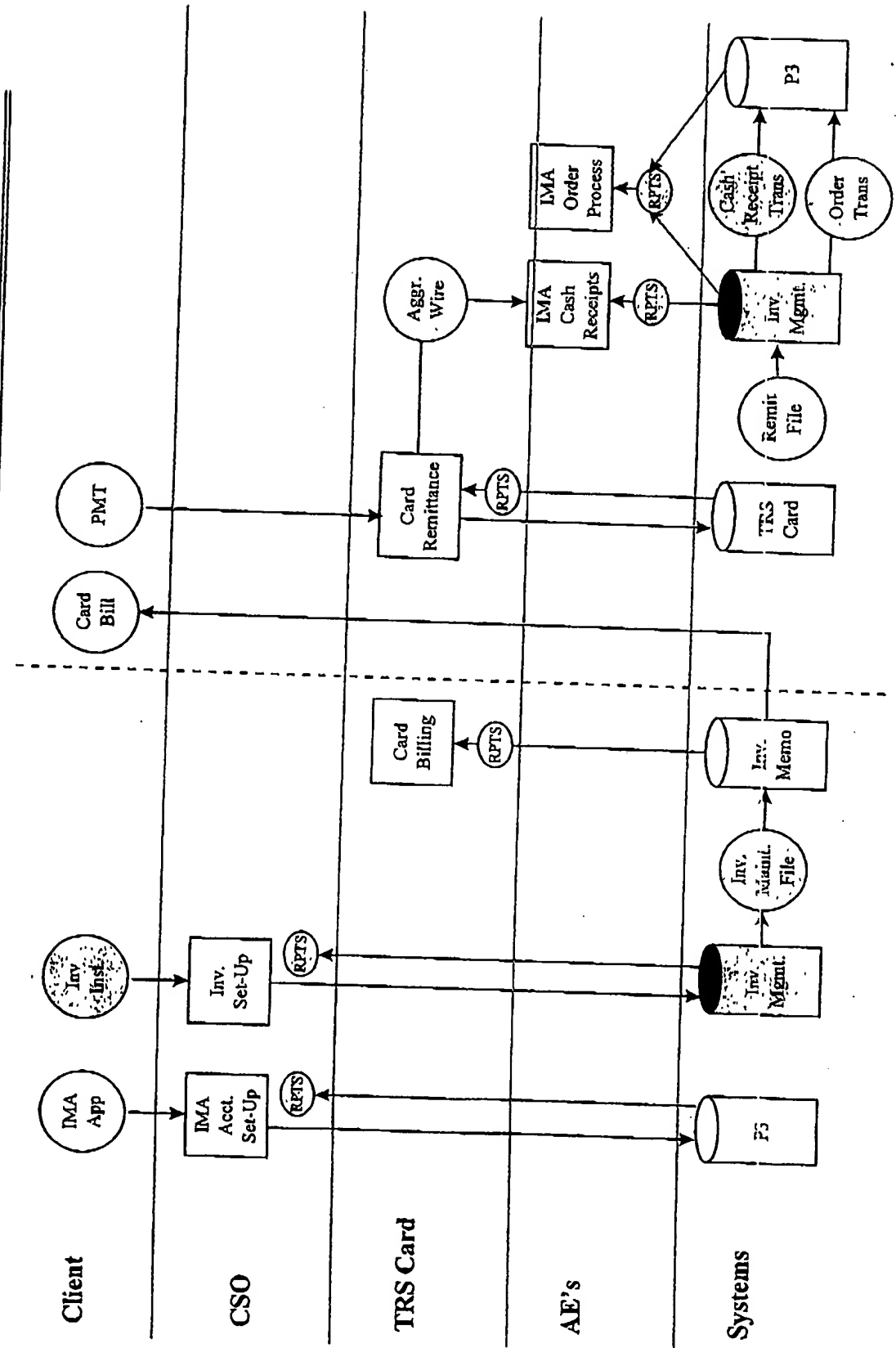
<u>Task</u>	<u>Date</u>
Outstanding issues resolved	12/15
Hi-level Cost Benefit Analysis written and submitted	12/20
SQL Prioritization	12/24
Hi-level business requirements defined	12/24
Cost estimates from Legacy	12/20
PDR completed	1/19

**Private Assets Functionality**  
**Current RCP Remittances & Settlement Process**



FILED 11/17/97

# Appendix B





# **EXHIBIT 24**

# INVESTING ON THE CARD

## Billing - Data Flow

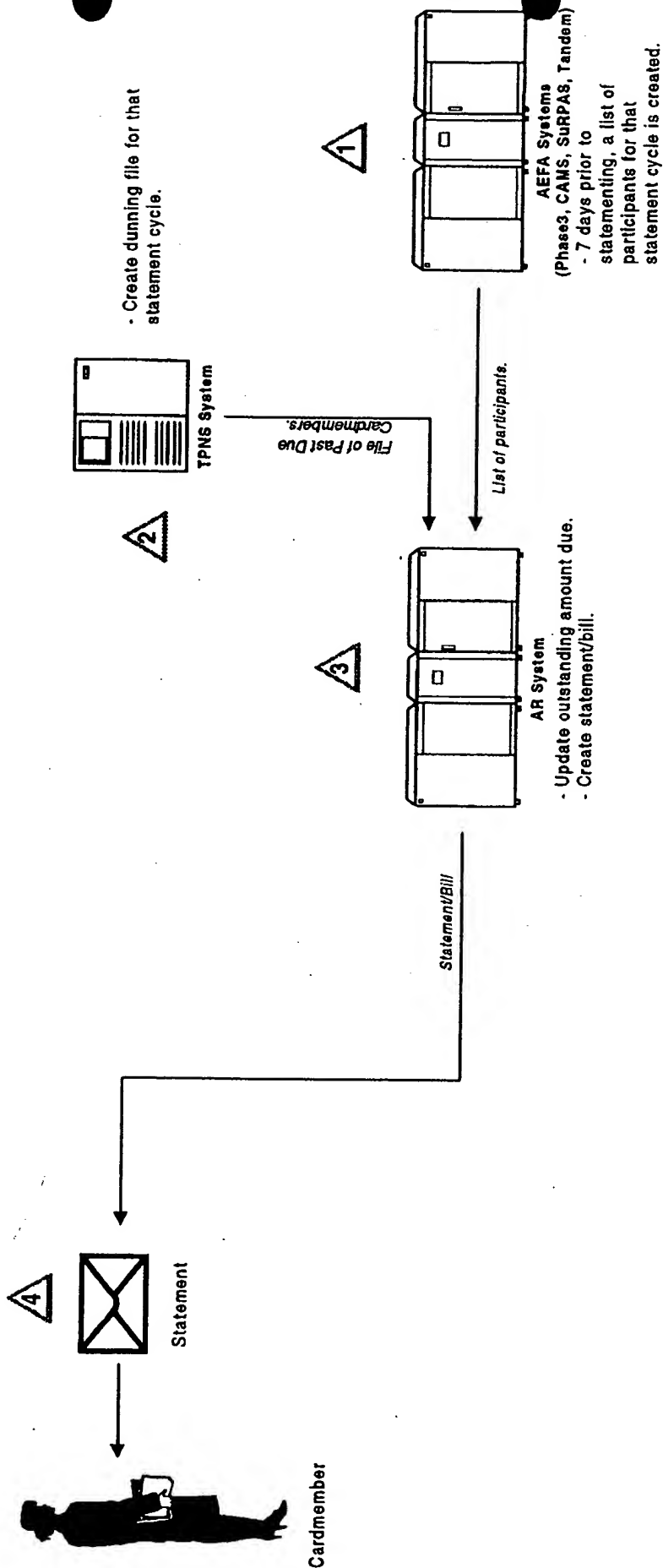
VB-34

03/11/98 17:10

0212 619 9625

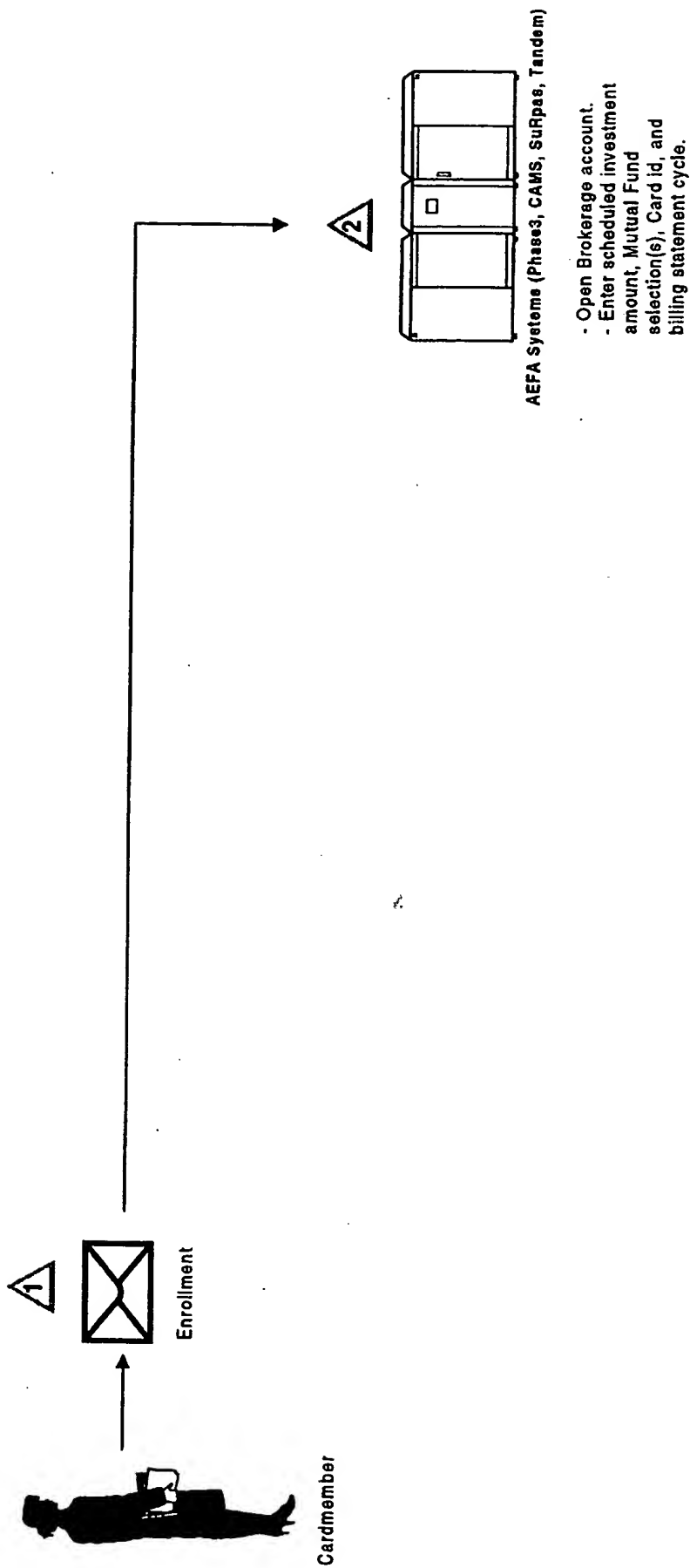
AEFD TECHNOLOGY

006/007



TRS ————— AEFA —————

# INVESTING ON THE CARD Account Setup - Data Flow



# **EXHIBIT 25**



VB-34

April 21, 1998

-Bogged down-

American Express Company  
General Counsel's Office  
World Financial Center  
New York, NY 10285

Richard Phillips  
Kirkpatrick & Lockhart  
1800 Massachusetts Avenue, N.W.  
Washington, D.C. 20036

Dear Dick:

We are faxing a small package of materials which outline our efforts to design an "Investing on the Card" Program without triggering broker-dealer registration requirements for American Express Travel Related Services and 24 hour pricing requirements for American Express Financial Advisors.

The package consists of the following items:

1. Project objective and background explanation
2. Investing on the Card data and money flow process
3. An outline of legal issues

Please review the attached materials in preparation for our April 22, 10:00 a.m conference call. At this point, we simply want to get your initial, high level reaction to the way we have addressed what we believe to be the two major issues:

- a. Broker-dealer registration issues under Section 15(b) of the 1934 Securities Exchange Act and
- b. Pricing issues under Section 22c-1 of the Investment Company Act of 1940.

In the outline of issues, you will notice that we have also highlighted certain sections with specific issues we'd like for you to consider. We would also like to hear your opinion on how we can most likely obtain approval from the SEC (e.g., formal or informal meeting; informal telephone call; or an SEC No-Action Letter).

change in bus. & reg. environment - M.F.'s are now diff. b.  
than so many diff. changes - & so many people  
are respon. for collectg. & formerly M.F.

reg. as a transfer agent - TRS

most imp. problem -> 22c-1  
payment problem - clerical/ministerial act - Amex is going to take responsibility  
for safety of \$\$. DIV. of market reg. is hard to move off of a dime.  
where is danger to investors...

# 105152

electronic systems

Agreement

K w/ collector  
"Daly". transfer agent  
to transfer w/ in 72 hrs.  
to say some prov. we put in w/ our  
best customers.  
Same deal - comp. will be diff.

NR's? ✓

60/40

Back on letter sent in by TRS offer as  
a feature. P. bill paying.  
We prepare a draft instruction letter  
call up SEC. We have a very mt. issue  
wed like to discuss. Send draft &  
schedule a meeting in a week.  
Go on 22c-1 issue  
take position clerical/ministerial  
task - act as  
agent for customers  
let them bring up  
15(b) issue.  
B/D & B/D  
will make an  
arrangement w/  
travel div.

Bank,  
pension plan administrators

We will call you at 10:00 a.m. on Wednesday to discuss further.

Sincerely,



Sheri Beck



Rockell Metcalf

RCM/II

cc: Colleen Curran  
Stephanie DiJinis

## Investing on the Card—An Outline of Issues

### **I. Whether TRS's collection of mutual fund payments is a broker-dealer activity, requiring registration under Section 15(b) of the 1934 Securities Exchange Act.**

A major hurdle in obtaining SEC approval of AEFD's Investing on the Card Program is convincing the SEC that TRS's collection of mutual fund moneys is not a broker-dealer activity, requiring TRS to register under Section 15(b) of the 1934 Securities Exchange Act.

#### **A. The relevant statutory provisions**

Section 15(b) of the Exchange Act provides that "it shall be unlawful for any broker or dealer to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security, unless the broker or dealer is registered in accordance with Section 15(b)."

Section 3(a)(4) of the Exchange Act defines a broker as any person, other than a bank, "engaged in the business of effecting transactions in securities for the account of others."

Section 3(a)(5) of the Exchange Act defines a dealer as any person, other than a bank, "engaged in the business of buying and selling securities for his own account," through a broker or otherwise.

#### **B. The conduit theory**

In a series of SEC no-action letters, the SEC has suggested that an unregistered entity which receives funds from mutual fund customers would be required to register as a broker-dealer, even when funds were received and then remitted to a registered broker-dealer for processing. **See Investment Company Institute, SEC No-Action Letter (June 13, 1973); State Security Life Insurance Company, SEC No-Action Letter (June 7, 1971); Investors Insurance Corporation, SEC No-Action Letter (May 10, 1971).**

We can respond to the forgoing obstacle in two specific ways:

1. Argue that because mutual fund money is flowing through TRS and immediately being remitted after two business days to AEFA, the mutual fund money is technically not being "received" by TRS and, as a result, broker-dealer registration is unwarranted. Webster's definition of "receive" will help in our analysis. (Receive means "to take in, hold, or contain"). TRS is not holding, possessing, or taking control of customer's mutual fund moneys. As a result, TRS cannot be deemed to be "effecting transactions in securities" or "engaged in the business of buying and selling securities." ✓

2. If the SEC disagrees with the foregoing argument, we should argue that there is no need for the SEC to have direct regulatory control over TRS merely because it is deemed to be "receiving" funds since TRS's activity is clerical and ministerial.

### C. The collection agent/clerical or ministerial theory

Both the SEC and the NASD have stated that an entity or person is not "effecting transactions" or inappropriately dabbling in the securities business if it is merely carrying out a clerical and/or ministerial function. See, e.g., Chubb Securities Corporation, 1993 SEC No-Action Letter, Lexis 1204; Aetna Casualty and Surety Company, 1988 SEC No-Action Letter, Lexis 386. See also NASD By-Laws, Persons Exempt from Registration, Rule 1060(a)(1) (providing that "persons associated with a member are not required to be registered if their functions are solely and exclusively clerical or ministerial.")

We need to persuade the SEC that when TRS is collecting mutual fund money, it is merely acting as a collection agent, whose function is solely and exclusively clerical and ministerial. We can successfully argue this point by contending that when TRS employees merely open an envelope, which contains payment for mutual fund shares and charge card payments, their function is clearly limited to a ministerial and/or clerical capacity. Employees at our outside advertising agency draft mutual funds advertising. That's more discretionary than opening an envelope and neither they nor the agency is required to register as a broker/dealer.

We can also bolster our argument by outlining those discretionary activities that TRS and TRS employees will not be engaged in:

1. Neither TRS nor its employees or affiliates will market the availability of mutual funds on the Card. (All marketing material, which will prominently indicate that AEFD is the registered broker-dealer, not TRS, will be communicated by AEFD.) (Determine whether Dick believes we need to do this). year later - we go back to SEC - sep piece of paper
2. No TRS employees or affiliates will have an opportunity to offer, solicit offers to buy or otherwise effect transactions since their tasks will be limited to opening envelopes.
3. No TRS Card operators will be permitted to recommend, endorse, respond to questions or engage in negotiations involving AEFD brokerage accounts or related securities transactions. Rather, TRS card operators will be given a script instructing them to direct all inquiries to AEFD's (1-800) Client

established bill pay mech - could allow you to pay bill w/ card

Simply let bill pay mech also pay bill of M.F.?

imp. to say TRS will only be the bill collection agency

we want to include payment for m.f. for customer of B.D. we'd like to offer service to other B.D.'s!

we are not focus on as security not limited to affiliate operation - not appeal of our feature of bill pay mech

AEFD - OK to me TRS Card handling as any instrument to market...

22-c-1 sent to AEFD - are appropriate as an agent of the customer to form proceeds to a m.f. TRS agent of customer - not as agent of B.D. 22-c-1 starts when B.D. receives from agent



Service number where <sup>callers?</sup> their securities-related questions will be answered by registered representatives of AEFD.

4. Neither TRS nor any TRS employees or affiliates will receive compensation tied to particular securities transactions. Rather, TRS will receive discount revenue from AEFD as it would from any other service establishment accepting payment for goods or services through the Card. (Intercompany Agreement)

If the SEC is still concerned about the limited activity of TRS employees opening envelopes and temporarily handling mutual fund money, we could offer to have an AEFD compliance officer conduct periodic inspections and periodically supervise the mail room to ensure that mutual fund money is being handled appropriately and remitted appropriately to AEFD. **We need to confirm whether this is possible since TRS has outsourced most of its mail room functions. (We need to be sure the SEC understands that TRS has outsourced most of its mailroom functions to third party vendors).** We can also ensure the SEC that there will be no risk to investors because AEFD will assume the risk of loss for any breakdown of the transfer process from TRS <sup>to</sup> AEFD. Moreover, we could offer to limit monthly mutual fund payments to \$500.00 or limit participants to 50,000 for the year during the pilot phase of the program in the interest of protecting investors and minimizing the risk of systems problems. **(Business partners aren't going to like these kind of limitations - Determine whether Dick believes these kind of limitations are even worth offering to the SEC).** **We need to confirm whether business partners can support this idea.** Identifying these safeguards should convince the SEC that there is no real need for TRS to be subjected to the regulatory regime of the SEC.

Fixed transaction fee - not a percentage  
No commission  
avoid suggestion that there is transaction based comp calculated on value of transaction

No need to limit

#### D. Bad SEC No-Action Letters

We should also be prepared to distinguish a few recent SEC no-action letters:

1. See Lincoln Financial Advisors Corporation, SEC No-Action Letter, Lexis 303 (1998), where Lincoln sought to enter into arrangements with certain insurance companies and their affiliated agencies through which those insurers and agencies would distribute various products, including mutual funds. The SEC denied Lincoln's no-action request.

The Lincoln request is readily distinguishable from AEFD's request because under the Lincoln arrangement, insurers and agencies were actively and intimately involved in selling mutual funds and in providing referrals, market research, marketing support and administrative services to Lincoln. TRS's role, on the other hand, would be restricted to collecting mutual fund payments and remitting them to the registered broker-dealer.

Amex takes full responsibility of funds  
Customers have asked Amex to travel to BD  
AEFD/TRS

2. See BSC Financial Corporation, SEC No-Action Letter, Lexis 814 (1996), where a broker-dealer (BSC) sought to develop a networking arrangement with certain health insurers to offer securities to doctors and other health care providers without the insurers having to register as a broker-dealer. The SEC denied BSC's no-action request.

Under the more conservative of two BSC arrangements, insurers sought to market and even distribute securities advertising materials. The broker also sought to pay a one-time cash referral fee to unregistered employees, who made a referral to the broker-dealer.

Under the more aggressive arrangement, an employee of the Insurer would become registered and also be an employee of the broker. These joint employees would solicit business, make recommendations, and assist health care providers in selecting and acquiring their securities. In addition to joint employees being compensated by salary and/or commission related to the volume of sales, the broker-dealer sought to pay the insurer fees for providing referrals to interested customers, customer lists, and clerical assistance.

The Investing on the Card Program is easily distinguishable from the BSC letter because TRS does not seek to market securities offered through the Investing on the Card Program. The Card is simply a method for payment. Since there will be no payments of referral fees to TRS, or its employees or affiliates, there will not be an incentive for TRS, or its employees or affiliates to engage in any activities requiring registration (e.g., recommending or endorsing securities products). TRS will only be paid nominal discount revenue, which is for less than the discount revenue it receives from other service establishments who accept the Card as payment for goods and services. *or any. had to see. for another*  
**(We need to confirm that this is true and be specific).**

#### E. Miscellaneous

TRS still executes the mailroom functions at the Chicago Remittance Center. ✓  
If all else fails, (as a last resort) we could offer to make the mailroom in Chicago a branch office and make TRS employees, who are "collecting" money dual employees of AEFD so that they are subject to AEFD's direct supervision and control. All program participants would mail their card/mutual fund payments to the branch office/mailroom in Chicago. We could also offer to use AEIS's (broker dealer) bank account for receipt of funds. *J. bank account*  
We need to explore the ramifications of offering this kind of a solution, and we need to get Dick's reaction in terms of whether it's worth offering; whether it should be offered initially; or whether it should only be offered as a last resort, etc.

II. Pricing Issues under Section 22c-1 of the Investment Company Act of 1940

- A. Receipt under 22c-1 does not apply at TRS, but at AEFA level, AEFA is the distributor, TRS is none of the entities set forth in the rule and is not functioning in any of the capacities contemplated in 22c-1) See Charles Schwab & Co., SEC No-Action Letter (July 7, 1997). This is bolstered by the receipt argument identified in I. A-D. Question for Dick: How is this analysis affected by I. E, and the branch broker-dealer concept?
- B. If 22c-1 applies at AEFA level, due to amount of expense involved (Rockell-- How much?) to update systems to be able to comply with 24 hour pricing requirement, request exploratory "pilot" period or
- C. If 22c-1 applies at AEFA level, request 24 hour extension to pricing requirements analogous to the separate account 24 hour extension already set forth in 22c-1. Question for Dick: Is the fact that we have to "peel" the mutual fund money away from the TRS payments going to be viewed in any way as similar to the separate account situation?

American Express Financial Direct would like to offer Cardmembers the convenience of investing in Mutual Funds, held in either a brokerage account or a variable annuity(Privileged Assets Select Annuity), by being billed for these investments along with their other Card purchases.

The feature would be offered to all charge Cardmembers (Personal/Green, Gold and Platinum). When enrolling for the service, the Cardmember would designate the investment amount(s) and specific funds or variable annuity selections that he/she would like to contribute to. The contribution amount would appear on the Cardmember's billing statement - monthly, quarterly or annually - depending on the his/her preference. The contribution would be voluntary and the Cardmember could skip the payment without any impact to his/her credit rating. Non-payments exceeding 60 days would be dropped from the statement.

Payments received from Cardmembers would be applied against a pre-determined hierarchy to determine the portion of this payment that should be invested in Mutual Funds. This investment amount would be used to purchase Mutual Fund shares per the Cardmember's election at enrollment.

Payments received prior to 2:00pm would be invested on the next business day at that day's closing price.

Cardmembers could make withdrawals from Funds by calling a toll free number.

Brokerage account advices and statements would be produced showing transaction details and account holdings.

## **I. Account Setup**

When a Cardmember chooses to enroll for the service, he/she would mail the enrollment materials directly to American Express Financial Advisors (AEFA), where the account would be set up on AEFA systems (CAMS, Phase3 for funds, Vanatage for variable annuity). The information required for account set-up would include the allocation of investment amount(s) across Mutual Fund(s), billing statement cycle, Card account to be billed.

AEFA will be set up as a Service Establishment (SE) on the TRS systems.

## **II. Billing**

Seven days prior to each billing cycle, the Phase3 system (in AEFA) will send a file to the AR system (TRS system which handles billing and payment processing) containing a list of participants for that statement cycle, their Card account numbers, investment elections (investment amount and Fund), AEFA's SE number(s), etc.

The AR system will determine whether a Mutual Fund payment has been made and will transmit a file to the TPNS (TRS system which tracks past due amounts) utility system. TPNS will determine the amount of temporary credits to be issued to customers who are 30 days late in their Mutual Fund payment. For customers who are 60 days late, a permanent credit will be given, as these are to be dropped from the billing statement. This file is transmitted back to the AR system.

The AR system runs a pre-statement cut job which creates transactions for the temporary and permanent credits. The pre-statement cut job ensures that the appropriate credits are applied to the statement and that no finance charges are assessed against a late Mutual Fund payment.

The AR system then produces Cardmember billing statements for that billing cycle.

### III. Payments

When payments are received, they are entered into the REMIT system (a TRS system which enters the payment) where the funds are captured. This system interfaces with the FINCAP system (a TRS system) which captures all financial events. These systems run throughout the day, seven days a week. Payments received prior to a 2:00pm cutoff are processed through these systems in time for that night's batch job.

The batch job is run on the AR system once each day (seven days a week), where the payment is run against a pre-determined hierarchy to determine the Mutual Fund investment amounts. This batch job typically starts at 11:00pm each night and runs through the night until 7:00pm the next day, when a file of investment amounts for each participant will be produced and transmitted to AEFA. Also, a file for TPNS is produced at this time containing past due Cardmembers.

The file containing Mutual Fund investment amounts for each participant will be transmitted to the AEFA Phase3 system (brokerage system for funds) or Vantage system (for PASA). Other AEFA systems (SuRPAS, Tandem) will determine the Fund values for that day and credit the Cardmembers accounts.

Upon reconciling the AR system, TRS accounting will transfer the aggregate Mutual Fund investment amount to AEIS, clearing broker for AEFD. This transfer to AEIS will be received from by approximately 12:00 PM on the third day in time for settlement. AEIS will then distribute the money to the appropriate fund companies and/or AEFA treasury.

### IV. Float Earnings

Cardmembers payments received prior to 2:00pm will be credited to their brokerage accounts

the next day. Float will be earned on this money for 1 day. Earnings from float will be retained by TRS. TRS will also earn discount revenue from AEFD as they would from any other service establishment.

Payments received after 2:00pm are considered on the next business day.

#### **V. Additional Notes**

- In the event that file or money transfers are delayed, an "as of" will credit the clients account for the second day price.
- PASA investments and mutual funds investments will be handled on different AEFA systems.

# **EXHIBIT 26**



Financial  
Direct

VB-34

## Memorandum

Date: May 11, 1998 City: New York  
From: Brian Kleinberg *BK* Office: FD Executive  
Subject: INVESTING ON THE CARD  
To: Rockell Metcalf  
cc: John Cattau Colleen Curran  
Sally Cooper Nancy Jones

I spoke to David House and Kerry Hatch from S/E and obtained their agreement that for the SEC approval process, we can state that we will not pay a discount rate for IOC. We need to follow-up with S/E (Kerry's group) to ensure that we determine fair pricing, methodology and operational feasibility for implementation.

Please let me know if there is anything else required on this topic.



# **EXHIBIT 27**



VB-34

## Memorandum

Date: June 10, 1998 City: New York  
From: Brian Kleinberg *B* Office: Financial Direct Executive  
Subject: INVESTING ON THE CARD  
To: Phillip Riese  
cc: Colleen Curran Rockell Metcalf

The attached requires your immediate attention.

We are proceeding with the process to obtain SEC approval for allowing TRS and AEFA to implement Investing on the Card. The attached letter is scheduled to be sent this Friday, therefore your review and any comments are necessary by Thursday. Please forward them to either Rockell Metcalf (General Counsel in NY) or myself.

This document has been reviewed and approved by attorneys throughout Amex.

Please pay particular attention to sections:

- I Introduction
- II The Payment Process
- III Limitation on the Activities of TRS

Within Section II, the last paragraph responds to the SEC's historical concerns about unregistered entities (like TRS) handling mutual fund monies. It provides that TRS will assume full responsibility for the safety of the Cardmember's mutual fund monies while the monies are within TRS's control (e.g., TRS will make good on the funds in the unlikely event they are misplaced or lost during the transfer process from TRS to AEFA). Of course, this guarantee of safety will not have a significant economic impact on TRS and it will not apply once the mutual fund monies have been transferred to AEFA for investment.

Thank you for your prompt attention.

[Date]

Ms. Catherine McGuire  
SEC Chief Counsel  
Division of Market Regulation  
Securities and Exchange Commission  
SEC Stop 7-10  
450 5<sup>th</sup> Street, N.W.  
Washington, D.C. 20549

Mr. Douglas J. Scheidt  
SEC Chief Counsel  
Division of Investment Management  
Securities and Exchange Commission  
SEC Stop 9-5  
450 5<sup>th</sup> Street, N.W.  
Washington, D.C., 20549

Dear Ms. McGuire and Mr. Scheidt:

We are submitting this letter on behalf of American Express Travel Related Services Company, Inc. (TRS) to obtain assurances that the staff of the Securities and Exchange Commission (Commission) would not recommend enforcement action to the Commission if TRS establishes and operates a bill processing arrangement for American Express customers (Cardmembers) in the manner described below. Specifically, TRS requests the assurances of the Division of Investment Management that this arrangement does not violate the pricing provisions of Rule 22c-1 under the Investment Company Act of 1940 (1940 Act). Moreover, TRS seeks the assurances of the Division of Market Regulation that it would not recommend enforcement action if TRS proceeds in the manner described below and does not register as a "broker" or "dealer" under Section 15(a) of the Securities Exchange Act of 1934 (Exchange Act).

# I. Introduction

TRS offers individual consumers a variety of products and services, including charge cards such as the American Express® Card, the American Express® Gold Card and the Platinum Card® (collectively, Charge Cards)<sup>1</sup>. Charge Cards are primarily designed as a method of payment or a bill paying mechanism and not as a means of financing purchases of goods or services. Specifically, Charge Cards do not involve

<sup>1</sup> TRS offers its Charge Cards through its wholly-owned subsidiary, American Express Centurion Bank, a Utah-chartered FDIC-insured financial institution.

# 108241

P. 02/11

FAX NO. 212 819 8942

JUN-09-98 TUE 11:08 AM YING

Ms. Catherine McGuire

Mr. Douglas J. Schcidt

[Date]

Page 2

an extension of credit by TRS to Cardmembers.<sup>2</sup> Moreover, Charge Cards require the Cardmember to pay the full amount billed each month, and do not contemplate the accrual of finance charges. The program described herein will not be offered by TRS in connection with any of its revolving credit card products.

TRS is a wholly-owned subsidiary of American Express Company. TRS initially plans to make its proposed bill paying service available to Cardmembers with respect to the investments they make in mutual funds and variable annuity products distributed by American Express Service Corporation, a wholly-owned subsidiary of TRS (AESC). AESC is a registered broker-dealer under the Exchange Act and a member of the National Association of Securities Dealers, Inc. AESC distributes various investment products such as no load mutual funds and variable annuities. In addition, investors may open a brokerage account with AESC. TRS plans to make its bill paying services available to Cardmembers in connection with such brokerage accounts as well. Typically, such accounts would serve as a vehicle for subsequent investment into one of the specific investment products noted.

TRS proposes to enter into an arrangement with AESC and individual Cardmembers, so that Cardmembers can use the Card to make periodic purchases of mutual fund shares or variable annuity products directly, or indirectly, through direction of those amounts to a brokerage account. This proposal is in direct response to numerous requests from Cardmembers who desire a more convenient mechanism to pay for investment products.<sup>3</sup>

Under the proposed arrangement, a Cardmember will send a single check, payable to TRS, for both regular Charge Card purchases and for the purchase of mutual fund shares. TRS will in turn promptly forward the payment for mutual fund shares to AESC and investors will receive the price on their mutual fund shares which is next computed after receipt of the order by AESC. TRS intends to enter into similar bill processing arrangements with other affiliated and non-affiliated third party broker-dealers and is requesting no-action relief with respect to any such arrangements as well.

<sup>2</sup> In contrast, the Division of Market Regulation recently addressed and granted an order of exemption in connection with the extension of credit to purchase shares of a business development company over the Internet. See Technology Funding Securities Corporation, May 20, 1998. Because TRS' proposal only involves Charge Cards, it does not implicate the Exchange Act issues addressed in that exemption.

<sup>3</sup> For over eight years, Cardmembers have used regular Card billing for contributions to the fixed annuity products offered by AESC. Many of these Cardmembers have requested that variable investments be made available via this flexible, convenient method of payment.

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## II. The Payment Process

Prior to the commencement of the bill paying service with respect to a Cardmember's account, he or she will notify AESC of the amount the Cardmember intends to invest on a monthly basis, the specific funds or variable annuity selections the Cardmember would like to contribute to, and the allocation of investment amounts to each investment. The Cardmember may make withdrawals and changes to his or her brokerage account or terminate participation in the service by calling a toll free number administered and serviced by AESC.

The Cardmember's intended investment amount will be reflected on his/her American Express Card billing statement as a reminder to remit such amount—monthly or quarterly depending on the Cardmember's preference. Since each investment is voluntary, non-payment will not affect the Cardmember's ability to charge on the Card, and unpaid investment amounts will not accrue interest or other charges.

The Cardmember will send a single check in payment of his/her regular Charge Card bill along with the specified investment amount to a TRS processing center in one of several states.<sup>4</sup> TRS, acting only as a conduit, will immediately enter the payment into its payment remit system. Payments received prior to a 2:00 p.m. cutoff will be processed through TRS's payment processing systems and promptly forwarded to AESC. Investors will then receive the price next computed after receipt of the order by AESC.

During the transfer process of investment monies from TRS to AESC, there will be no risk of loss to investors. From the time the intended investment amount is received by TRS until the time of investment, TRS will assume full responsibility for the safety of the Cardmember's intended investment amount.

## III. Limitations on the Activities of TRS

TRS will act only in the capacity of a bill processor, which collects and promptly forwards the intended investment amount to AESC at the direction of the Cardmember.

<sup>4</sup> Although the mailroom and remittance functions of all but one of these processing centers have been outsourced to third parties, such outsourcing does not affect the responsibility of TRS to the customer.

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1. **Limitations on Marketing.** Neither TRS nor its employees or any non-broker-dealer registered affiliates will market the availability of this administrative service or the underlying products and services offered by AESC.
2. **Limitations on Activities of Processing Center Employees.** No TRS employees or non-broker-dealer registered affiliates at TRS processing centers will be involved in effecting transactions in securities. Instead, their tasks will be restricted to opening envelopes and entering the intended investment amount into TRS's payment processing system.
3. **Limitations on Activities of TRS Customer Service Associates.** No TRS Customer Service Associates will be permitted to recommend, endorse, respond to questions or otherwise discuss matters involving brokerage accounts, mutual funds or related securities transactions. Rather, TRS Customer Service Associates will be trained to direct all securities related inquiries to a (1-800) Client Service number at AESC. In addition, an AESC (1-800) Client Service number will appear on the Cardmembers' Charge Card statement for any service issues pertaining to their investments.
4. **Limitations on Credit.** TRS will not extend credit to any Cardmember for the purpose of purchasing securities through, or carrying securities with AESC.
5. **Limitations on Compensation.** TRS will not receive a referral fee of any kind from AESC nor will it receive any compensation that is based upon the total dollar amount invested by a Cardmember. Rather, TRS will charge a fee that will offset the expenses it incurs as a result of this service, together with a reasonable profit.

#### IV. Activities of AESC

Under the proposed arrangement, AESC will have exclusive responsibility for the following activities:

1. **Marketing.** Marketing materials describing the availability of TRS's bill processing service, the timing on pricing of mutual funds, and the underlying products and services offered by AESC will be distributed exclusively by AESC. AESC will review and be fully responsible for the content of all marketing materials, advertising and other informational materials regarding the service. Any such materials will clearly indicate that TRS is not a registered broker-dealer, that all investment related inquiries should be directed exclusively to AESC, that TRS is a separate entity from AESC, and that mutual funds are being offered through AESC and not TRS.

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2. **Securities Related Activities.** AESC will have responsibility for all securities related activities including, complying with all regulatory requirements, the opening of accounts, the entering of orders and the execution of transactions, setting up and maintaining customer files, and distributing order confirmations and statements after each payment is processed.
3. **Securities Related Questions and Servicing.** AESC will have responsibility for responding to all securities related questions and service issues through its (1-800) Client Service number.

#### V. Analysis of the Rule 22c-1 Pricing Issue

Under Section 22(c) of the 1940 Act and Rule 22c-1 thereunder, mutual fund shares must be priced based upon the net asset value next calculated after an order is received. The proposed arrangement will comply with Rule 22c-1 because the receipt of the order for purchase of mutual fund shares, within the meaning of Rule 22c-1, occurs at the time AESC receives the order.

Rule 22c-1 extends its stated pricing requirements only to registered investment companies, persons designated in an issuer's prospectus as authorized to sell or redeem a company's shares, or principal underwriters or dealers of such shares. Under the proposed bill processing arrangement, TRS will not act in any of the foregoing capacities. Rather, TRS will act as a bill processing agent at the direction of the Cardmembers. TRS will not be designated as AESC's agent in a fund prospectus or otherwise, nor has it been delegated any function in connection with AESC's mutual fund operation. Instead, TRS has designed a service that is intended to streamline bill paying for its customers.

The staff has agreed in certain other situations involving an investor, a "payment processing agent" and a mutual fund company that the pricing provisions of Rule 22c-1 would be triggered by receipt of an order by the mutual fund company or its designated bank, and not at the "payment processing agent" step. See, e.g., Patrick P. Badamy, M.D., SEC No-Action Letter, LEXIS 1495 (pub. avail. Apr. 7, 1972); Consolidated Programs, Inc., SEC No-Action Letter, LEXIS 1771 (pub. avail. Mar. 22, 1973). In the Badamy letter, the staff recognized that a custodian or trustee under a Keogh Plan does not function as a dealer, underwriter, or fund designee as set forth in Rule 22c-1, but instead as the mutual fund purchaser's agent. As a result, Rule 22c-1 would apply at the fund, underwriter or fund designee level. Similarly, in the Consolidated Programs letter (CPI), the staff issued assurances with respect to CPI's proposal to act as agent for individual mutual fund purchasers, receiving their payments for fund share purchases through a computerized billing system and forwarding them to the fund's designated bank. Under CPI's proposal,

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customers would receive the fund share price next computed after receipt by the fund's bank.

The facts presented in CPI bear a strong resemblance to the bill processing arrangement proposed by TRS. Like CPI, TRS proposes to institute a bill processing service to provide enhanced convenience to mutual fund purchasers. While TRS's proposed service will be launched with respect to AESC and its investment products, the service may in the future be expanded to allow Cardmembers to direct investments to the products of other fund groups. Although in its letter CPI noted that it was not affiliated with any mutual fund advisor or custodian, we do not believe the fact that TRS is affiliated with AESC should alter the staff's conclusion. In Badamy, the staff specifically addressed the fact that payment processing agents would be recommended by a fund and determined that such a recommendation would not change the analysis. Like the investor agents in that case, TRS will be acting solely as an agent of the purchaser, despite its affiliation with AESC; as a result, TRS should not be subject to the timing requirements of Rule 22c-1.

Our position is consistent with the policies underlying Rule 22c-1. In the Release adopting the rule, the Commission made clear that one of its most important purposes was to address the speculative practices which could result from backward pricing. Specifically, the Commission expressed its concern that the purchase or sale of fund shares at a price based upon a previously determined net asset value could permit a speculator to take advantage of fluctuations in the prices of the fund's underlying securities that occurred after the fund last calculated its net asset value.<sup>5</sup> The proposed program is fully consistent with this aim, as purchases of fund shares will be effected at the next computed price upon receipt of the order by AESC. There is no opportunity in the process for speculation by investors. To participate in the proposed program, investors will choose the convenience of purchasing mutual funds and paying Charge Card balances by writing a single check to TRS. Because the marketing materials prepared and distributed by AESC will fully disclose the mechanics of this arrangement, Cardmembers will be informed that pricing of their mutual fund purchases will occur when their order is received by AESC and not when payment is received by TRS.

#### VI. Analysis of the Broker-Dealer Registration Issue

Because of the limited scope and nature of TRS's activities as a bill processing agent, we submit that neither TRS nor any of its employees or affiliates (other than AESC) are required to register with the Commission as broker-dealers under Section 15(b) of the Exchange Act in connection with this proposal.

<sup>5</sup> Investment Company Act Release No. 5519, October 19, 1968.



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Section 3(a)(4) of the Exchange Act defines a "broker" as any person, other than a bank, "engaged in the business of effecting transactions in securities for the account of others." Section 3(a)(5) of the Exchange Act defines a "dealer" as any person, other than a bank, "engaged in the business of buying and selling securities for his own account, through a broker or otherwise". Section 15(a) of the Exchange Act provides that "it shall be unlawful for any broker or dealer to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security, unless the broker or dealer is registered in accordance with Section 15(b)." (emphasis added)

Both the Commission staff and the NASD have long concluded that an entity or person is not "effecting transactions" or inappropriately dabbling in securities if it is merely carrying out a clerical or ministerial function. See Aetna Casualty and Surety Company, 1988 SEC No-Action Letter, LEXIS 386 (pub. avail. Dec. 21, 1987); Chubb Securities Corporation, 1993 SEC No-Action Letter, LEXIS 1204 (pub. avail. Nov. 24, 1993); Applied Financial Systems, 1971 SEC No-Action Letter, LEXIS 4075 (pub. avail. Sept. 25, 1971); Dreyfus Group Equity Fund, 1971 SEC No-Action Letter, LEXIS 1000 (pub. avail. Jun. 26, 1971). See also Exchange Act section 3(a)(18) (defining the term associated person of a broker or dealer to exclude those persons who perform purely clerical or ministerial acts); NASD By-Laws, Persons Exempt from Registration, Rule 1060(a)(1) (providing that "persons associated with a member are not required to be registered if their functions are solely and exclusively clerical or ministerial").

TRS's activities as a mere bill processing agent clearly fall within the activities which the staff has previously held to be purely clerical or ministerial in nature. The only function of TRS with respect to the securities business is to collect and promptly transfer periodic investment amounts to AESC in the interest of convenience and at the direction of the Cardmember.

As described above, AESC, a registered broker-dealer, will be responsible for all marketing activities related to TRS's proposed bill processing arrangement as well as for the underlying products and services offered by AESC. TRS will not advertise its role as a bill processor of Cardmembers' investment payments to AESC. AESC will have exclusive responsibility for the opening of accounts, the entering of orders, the execution of transactions, transferring investment monies to the appropriate mutual fund companies, and distributing account confirmations and statements. TRS will engage in none of these securities-related activities. Rather, TRS will restrict its activities to the ministerial tasks of opening envelopes, entering the intended investment amount into TRS's payment processing system and promptly forwarding such payment to AESC. AESC is responsible for responding to all Cardmembers' securities-related questions and service issues. TRS employees and unregistered affiliates will be strictly prohibited from recommending, endorsing,

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responding to questions or engaging in any negotiations involving brokerage accounts or related securities transactions.

In light of the limited nature of TRS's role as a bill processing agent, engaged in exclusively clerical and ministerial functions and AESC's role as the registered broker-dealer, responsible for all marketing and securities related activities, TRS should not be required to register as a broker-dealer. While several SEC no-action letters lend strong support to our conclusion, the Aetna Casualty and Surety no-action letter, *supra*, is particularly applicable because it involved a bill processing arrangement similar to the one proposed by TRS.

Just as TRS is seeking to extend the Charge Cards' use as a bill paying mechanism to include payments for mutual funds, Aetna, an insurance corporation, sought to extend its authorized check plan (the Aetna Service Account) to include payments for variable life insurance policies, a securities product like the mutual funds in this case. Aetna's proposal allowed customers, who had more than one insurance and variable life insurance policy to send a single monthly payment to Aetna, an entity not registered as a broker-dealer. Aetna, in turn, would process and allocate premiums on variable life insurance policies as well as on casualty and property insurance. The staff granted Aetna's no-action request concluding that Aetna, as a mere conduit of funds, was only engaged in clerical and ministerial activities.

The same rationale should apply with equal force to TRS's proposal. TRS, like Aetna, has effectively limited its role to that of a conduit which collects and promptly transfers investment monies to a registered broker-dealer. The TRS proposal, like the Aetna proposal, protects investors from risk of loss inherent in any breakdown during the transfer process. In addition, the regulatory requirements and responsibilities imposed on AESC as a registered broker-dealer and the contractual restraints and strict limitations imposed on TRS as a bill processing agent so greatly minimize any risk to the public that no purpose would be served by subjecting TRS to the regulatory authority of the Commission. Therefore, the staff's conclusion that Aetna would not have to register as a broker-dealer applies directly to TRS.<sup>6</sup>

On several other occasions, the staff has agreed that broker-dealer registration is unwarranted when entities and/or persons perform clerical and ministerial services similar to the kind of bill processing service proposed by TRS. See Carlos M. Urrutia, 1980 SEC No-Action Letter, LEXIS 3729 (pub. avail. Sept. 26, 1980).

<sup>6</sup> This result is not affected by the fact that investors will send a check payable to TRS that will include payment for mutual funds because TRS, as a mere conduit, will not have control of investment monies. See Aetna No Action Letter, *supra*, where the staff agreed that "no control of customer's funds by Aetna exists, even if Aetna has momentary possession of these funds...because Aetna handles the funds only pursuant to customers' directions to transfer them...."

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(taking and transmitting orders for securities, determined to be a clerical and ministerial service); Dreyfus Group Equity Fund, SEC No-Action Letter, Lexis 1000 (pub. avail. Jun. 26, 1971) (maintaining shareholder records, processing investments and redemptions of mutual fund shares, data processing, and mailing shareholder information determined to be clerical and ministerial services). Like the entities involved in the foregoing no-action letters, TRS, as a bill processing agent, will perform a purely clerical and ministerial task and therefore will not effect securities transactions or otherwise engage in securities-related activities.

Historically, the staff has indicated a concern when non-registered entities become entangled in marketing activities<sup>7</sup> or enter into compensation arrangements based on securities transactions.<sup>8</sup> TRS has responded to the staff's historical concerns by ensuring that none of its activities involve, or even approach, the functions that are the hallmark of broker-dealer activity. TRS will not engage in any marketing activities related to its proposed bill processing arrangement or the underlying securities products that can be purchased through the service. As a result, the staff should conclude that TRS is not required to register as a broker-dealer for engaging in limited bill processing activities for AESC at the direction of Cardmembers.

#### IX. Conclusion

On the basis of the foregoing, we submit that TRS's role is not as an underwriter, dealer or other person designated by a fund to consummate transactions in its shares, but as the mutual fund purchaser's agent in the payment process. As such, the pricing requirements of Rule 22c-1 should not be triggered upon receipt of the payment by TRS, but at the point the order reaches AESC.

We further submit that since TRS's role is restricted to the ministerial task of collecting the intended investment and promptly remitting it to AESC in the interest of convenience and at the direction of the Cardmember, TRS should not be required to register as a broker-dealer under Section 15(b) of the Exchange Act.

<sup>7</sup> See Lincoln Financial Advisors Corporation, SEC No-Action Letter, Lexis 303 (1998) (the staff refused to take a no-action position where Lincoln sought to enter into arrangements with certain insurance companies and their affiliated agencies through which insurers and agencies would become actively and intimately involved in selling mutual funds).

<sup>8</sup> See George J. Baylor, SEC No-Action Letter, 1971 SEC No-Action Letter, Lexis 3245 (Sept. 5, 1971) (the staff issued a negative response to a proposal to establish a restaurant containing telephone lines to brokerage houses, where the restaurant would receive a transaction-based payment from those brokerage houses).

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Mr. Douglas J. Scheidt  
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If the staff believes it would be useful, we would be happy to discuss the foregoing with you and/or your staff at the Commission offices at your convenience. In any event, if the staff is inclined to issue a negative response to either of the foregoing requests based upon the facts specified above, we would appreciate the opportunity to discuss the matter with you. If you have any questions, please feel free to contact me at (612) 671-8626.

Sincerely,

Colleen Curran, Esq.

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# **EXHIBIT 28**




# Investing on the Card Market Test

**CONFIDENTIAL**

June 22, 1998

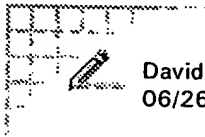
# **EXHIBIT 29**

VB-34


From: Colleen Curran @ IDS on 07/01/98 04:53 PM CDT  
To: David Hubers @ IDS  
cc: Rockell Metcalf, Sheri Beck @ IDS  
Subject: Re: Investing on the Card 

I talked to Craig Tyle and Amy Lancellotta at the ICI. Amy is drafting a short position paper to be distributed to you and the rest of the Executive Committee very soon. I sent her a copy of our no-action request on a confidential basis. The ICI position is that we shouldn't allow mutual funds to be purchased on credit because that could fuel today's market with speculative transactions by consumers who haven't experienced a market correction/crash. In the letter, the ICI will distinguish the charge card situation from the credit card situation. I will be out of the office the week after the Fourth. If you receive the ICI letter during that week, please forward it to Rockell and Sheri. I'm confident they will work with the ICI to make any necessary changes to support our position and they'll call me up north if there are any concerns.

David Hubers



David Hubers  
06/26/98 11:24 AM

To: Colleen Curran  
cc:  
Subject: Re: Investing on the Card 

(Note from Sandy) Colleen -- FYI Dave is on vacation starting today and I won't be talking to him for a few days. I'll leave it up to you on whether or not you call Craig today, but I don't think he would mind.



# **EXHIBIT 30**



Financial  
Advisors

Colleen Curran  
Vice President  
Assistant General Counsel  
Bus: 612 871 0026  
Fax: 612 871 3767

American Express Financial Advisors Inc.  
103 Tower 10  
Minneapolis, Minnesota 55440

September 8, 1998

Ms. Catherine McGuire  
SEC Chief Counsel  
Division of Market Regulation  
Securities and Exchange Commission  
SEC Stop 7-10  
450 5<sup>th</sup> Street, N.W.  
Washington, D.C. 20549

Mr. Douglas J. Scheidt  
SEC Chief Counsel  
Division of Investment Management  
Securities and Exchange Commission  
SEC Stop 9-5  
450 5<sup>th</sup> Street, N.W.  
Washington, D.C., 20549

Dear Ms. McGuire and Mr. Scheidt:

We are submitting this letter on behalf of American Express Travel Related Services Company, Inc. (TRS) to obtain assurances that the staff of the Securities and Exchange Commission (Commission) would not recommend enforcement action to the Commission if TRS establishes and operates a processing arrangement for American Express customers in the manner described below. Specifically, TRS requests the assurances of the Division of Investment Management that this arrangement does not violate the pricing provisions of Rule 22c-1 under the Investment Company Act of 1940 (1940 Act). Moreover, TRS seeks the assurances of the Division of Market Regulation that it would not recommend enforcement action if TRS proceeds in the manner described below and does not register as a "broker" or "dealer" under Section 15(a) of the Securities Exchange Act of 1934 (Exchange Act).

#### I. Introduction

TRS offers individual customers (Cardmembers) a variety of products and services, including charge cards such as the American Express® Card, the American Express® Gold Card and the Platinum Card® (collectively, Charge Cards).<sup>1</sup>

<sup>1</sup> TRS offers such Charge Cards either directly or indirectly through its wholly-owned subsidiary, American Express Centurion Bank, a Utah-chartered FDIC-insured financial institution.

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Charge Cards are primarily designed as a method of payment or a bill paying mechanism and not as a means of financing purchases of goods or services. Accordingly, this processing arrangement will not involve an extension of credit or an accrual of finance charges.<sup>2</sup> TRS will not make this processing arrangement available with respect to any of its revolving credit card products.

TRS is a wholly-owned subsidiary of American Express Company. TRS plans to make its proposed processing arrangement available to Cardmembers with respect to the investments they make in mutual funds and variable annuity products distributed by American Express Service Corporation, a wholly-owned subsidiary of TRS (AESC). AESC is a registered broker-dealer under the Exchange Act and a member of the National Association of Securities Dealers Regulation, Inc. (NASDR). AESC distributes various investment products such as no load mutual funds and variable annuities. In addition, investors may open a brokerage account with AESC. TRS plans to make its processing arrangement available to Cardmembers in connection with such brokerage accounts as well. Typically, such accounts would serve as vehicles for subsequent investment into one of the specific investment products noted.

TRS proposes to enter into an arrangement with AESC and individual Cardmembers, so that Cardmembers may appoint TRS as a processing agent to collect and promptly remit to AESC their voluntary, periodic payments for mutual fund shares or variable annuity products. TRS will not hold or control Cardmember funds, under this proposal, because it will only handle such funds pursuant to Cardmembers' directions to transfer such funds to AESC. Over a considerable period of time, a number of Cardmembers have requested the ability to purchase variable investments by means of the Card.<sup>3</sup> Over the past few years, we have evaluated how to safely and securely enable them to make these types of purchases. This proposal is the result of those requests and our careful consideration of the matter.

Under the proposed arrangement, a Cardmember will send a single check for both regular Charge Card purchases and for the purchase of mutual fund shares. TRS

<sup>2</sup> In contrast, the Division of Market Regulation recently addressed and granted an order of exemption in connection with the extension of credit to purchase shares of a business development company over the internet. See Technology Funding Securities Corporation, May 20, 1993. Because TRS' proposal only involves Charge Cards, it does not implicate the Exchange Act issues addressed in that exemption.

<sup>3</sup> For over eight years, Cardmembers have used Card payments as a mechanism for voluntary contributions to the fixed annuity products offered by AESC.

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will in turn promptly forward the payment for mutual fund shares to AESC and investors will receive the price on their mutual fund shares which is next computed after receipt of the order by AESC. The Cardmember may make withdrawals and changes to his or her brokerage account or terminate participation in the service by calling a toll free number administered and serviced by AESC.

TRS intends to enter into similar processing arrangements with other affiliated broker-dealers and is requesting no-action relief with respect to any such arrangements as well. TRS commits to refrain from entering into any similar arrangements with non-affiliated third party broker/dealers.

## II. The Payment Process

Prior to the commencement of the processing arrangement with respect to a Cardmember's account, the Cardmember will notify AESC of the amount he or she intends to invest on a monthly basis, the specific funds or variable annuity selections to which the Cardmember would like to contribute, and the allocation of investment amounts to each investment.

The Cardmember's intended investment amount will be reflected on his/her American Express Card billing statement as a reminder to remit such amount—monthly or quarterly depending on the Cardmember's preference. Since each investment is voluntary, non-payment will not affect the Cardmember's ability to charge on the Card, and unpaid investment amounts will not accrue interest or other charges.

The Cardmember will send a single check in payment of his/her regular Charge Card bill along with the specified investment amount to a TRS payment processing center in Chicago, Illinois (the Processing Center). TRS, acting only as a conduit, will immediately enter the payment into its automated payment remit system. Payments received prior to a 2:00 p.m. cutoff will be processed through TRS's payment processing systems and forwarded to AESC within forty-eight hours. Investors will then receive the price next computed after receipt of the order by AESC.

## III. Payment Processing Safeguards

We have designed this processing arrangement with the safety of the Cardmember's money as the paramount consideration. Therefore, from the time the intended investment amount is received by TRS until the time of investment, AESC will

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assume full responsibility for the safety of such funds. This guarantees that Cardmembers will not be exposed to any risk of loss by using TRS as a processing agent for their intended investment amounts.

Further evidence of our attention to the safety of the Cardmember's money lies in the extraordinary safeguards in place at the Processing Center.

1. Payment processing procedures are automated.
2. From the time a payment arrives at the Processing Center until it is forwarded to AESC for investment, employees rarely touch an individual check because they handle batches of mail at a time.
3. When mail is delivered by the courier, employees load it into a sorting machine, which cuts each envelope on three sides to open and sorts the contents into batches of 250-300 pieces. The contents of the envelopes are then manually transferred in batches to a scanning machine which photographs and electronically verifies and enters the amount of the check into the payment processing system. The payment processing system then determines how the Cardmember's payments should be allocated between regular charge card payments and investment amounts and electronically forwards the appropriate investment amount to AESC for investing.
4. All sensitive areas (i.e., mailroom, special processing areas) of the Processing Center have surveillance cameras. Moreover, site supervisors have monitors at their workstations, which allow them to view sensitive areas of the Processing Center at all times.
5. All sensitive areas of the Processing Center are under dual control. As a result, there is never just one employee in a sensitive location.

#### IV. Other Safeguards

In addition to the payment processing safeguards which already exist at the Processing Center, TRS proposes the following additional safeguards:

1. **Supervision of TRS's activities.** TRS's activities under this proposal, including all payment processing functions, will be supervised by AESC. AESC will assume full responsibility for establishing, maintaining, and diligently enforcing a strict system of supervision and surveillance over TRS's activities at the Processing Center.

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ATTENTION ADDRESS

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2. **Supervision of Processing Center Employees.** TRS's Processing Center personnel (i.e., those responsible for retrieving mail from couriers and loading batches of mail into the automated processing machines) will be treated and controlled as if they were "associated persons" of AESC within the meaning of Section 3(a)(18) of the Exchange Act. Furthermore, the Processing Center will have a registered principal of AESC on site monthly to conduct an audit for compliance with AESC's instructions to TRS and the representations and requirements contained in this letter.
3. **Background Checks.** TRS will conduct an investigation of the backgrounds of all personnel in special processing areas to assure that such persons are not statutorily disqualified from becoming associated with AESC.
4. **Books and Records.** All books and records of TRS will be readily accessible to the supervisory personnel of AESC, the Commission, the NASDR, and other appropriate regulatory authorities.
5. **Fidelity Bond.** All personnel in special processing areas will be bonded under fidelity bonds. As a result of such bonds, the possibility of loss due to dishonest or fraudulent acts will be effectively eliminated.

**V. Limitations on the Activities of TRS**

With respect to this arrangement, TRS will act only in the capacity of a processor, which collects and promptly forwards the intended investment amount to AESC at the direction of the Cardmember.

1. **Limitations on Marketing.** Neither TRS nor its employees or any non-broker-dealer registered affiliates will market the availability of this administrative service or the underlying products and services offered by AESC.
2. **Limitations on Activities of Processing Center Employees.** No TRS employees or non-broker-dealer registered affiliates at the Processing Center will be involved in effecting transactions in securities. Instead, their tasks will be restricted to a) transporting envelopes from the mail trucks to the mailroom, b) loading batches of envelopes into an automated processing system, and c) periodically verifying images of checks photographed by the scanner.
3. **Limitations on Activities of TRS Customer Service Associates.** No TRS Customer Service Associates will be permitted to recommend, endorse, respond

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to questions or otherwise discuss matters involving brokerage accounts, mutual funds or related securities transactions. Rather, TRS Customer Service Associates will be trained to direct all securities related inquiries to AESC. In addition, an AESC (1-800) Client Service number will appear on the Cardmembers' Charge Card statement for any service issues pertaining to their investments.

4. **Absence of Credit.** TRS will not extend credit to any Cardmember for the purpose of purchasing securities through, or carrying securities with, AESC. As noted above, this processing arrangement will be available only for charge cards and not for credit cards.
5. **Limitations on Compensation.** TRS will not receive a referral fee of any kind from AESC nor will it receive any compensation that is based upon the total dollar amount invested by a Cardmember. Rather, TRS will charge a fee that will offset the expenses it incurs as a result of providing this service, together with a reasonable profit.

#### VI. Activities of AESC

Under the proposed arrangement, AESC will have exclusive responsibility for the following activities;

1. **Marketing.** Marketing materials describing the availability of TRS's processing arrangement, the timing on pricing of mutual funds, and the underlying products and services offered by AESC will be distributed exclusively by AESC. AESC will review and be fully responsible for the content of all marketing materials, advertising and other informational materials regarding the service. Any such materials will clearly indicate that TRS is not a registered broker-dealer, that all investment related inquiries should be directed exclusively to AESC, that TRS is a separate entity from AESC, and that mutual funds are being offered through AESC and not TRS.
2. **Securities Related Activities.** AESC will have responsibility for all securities related activities including, complying with all regulatory requirements, the opening of accounts, the entering of orders and the execution of transactions, setting up and maintaining customer files, and distributing order confirmations and statements after each payment is processed.

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3. **Securities Related Questions and Servicing.** AESC will have responsibility for responding to all securities related questions and service issues through its (1-800) Client Service number.

#### VII. Analysis of the Rule 22c-1 Pricing Issue

Under Section 22(c) of the 1940 Act and Rule 22c-1 thereunder, mutual fund shares must be priced based upon the net asset value next calculated after an order is received. The proposed arrangement will comply with Rule 22c-1 because the receipt of the order for purchase of mutual fund shares, within the meaning of Rule 22c-1, occurs at the time AESC receives the order.

Rule 22c-1 extends its stated pricing requirements only to registered investment companies, persons designated in an issuer's prospectus as authorized to sell or redeem a company's shares, or principal underwriters or dealers of such shares. Under the proposed processing arrangement, TRS will not act in any of the foregoing capacities. Rather, TRS will act as a processing agent at the direction of the Cardmembers. TRS will not be designated as AESC's agent in a fund prospectus or otherwise, nor has it been delegated any function in connection with AESC's mutual fund operation. Instead, TRS has designed a service that is intended to provide a convenient way for Cardmembers to make voluntary payments for mutual fund shares.

The staff has agreed in certain other situations involving an investor, a "payment processing agent" and a mutual fund company that the pricing provisions of Rule 22c-1 would be triggered by receipt of an order by the mutual fund company or its designated bank, and not at the "payment processing agent" step. See, e.g., Patrick P. Badamy, M.D., SEC No-Action Letter, LEXIS 1495 (pub. avail. Apr. 7, 1972); Consolidated Programs, Inc., SRC No-Action Letter, LEXIS 1771 (pub. avail. Mar. 22, 1973). In the Badamy letter, the staff recognized that a custodian or trustee under a Keogh Plan does not function as a dealer, underwriter, or fund designee as set forth in Rule 22c-1, but instead as the mutual fund purchaser's agent. As a result, Rule 22c-1 would apply at the fund, underwriter or fund designee level. Similarly, in the Consolidated Programs letter (CPI), the staff issued assurances with respect to CPI's proposal to act as agent for individual mutual fund purchasers, receiving their payments for fund share purchases through a computerized billing system and forwarding them to the fund's designated bank. Under CPI's proposal, customers would receive the fund share price next computed after receipt by the fund's bank.

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The facts presented in CPI bear a strong resemblance to the processing arrangement proposed by TRS. Like CPI, TRS proposes to institute a processing arrangement to provide enhanced convenience to mutual fund purchasers. Although in its letter CPI noted that it was not affiliated with any mutual fund advisor or custodian, we do not believe the fact that TRS is affiliated with AESC should alter the staff's conclusion. In Badamy, the staff specifically addressed the fact that payment processing agents would be recommended by a fund and determined that such a recommendation would not change the analysis. Like the investor agents in that case, TRS will be acting solely as an agent of the purchaser. As a result, TRS should not be subject to the timing requirements of Rule 22c-1.

Our position is consistent with the policies underlying Rule 22c-1. In the Release adopting the rule, the Commission made clear that one of its most important purposes was to address the speculative practices that could result from backward pricing. Specifically, the Commission expressed its concern that the purchase or sale of fund shares at a price based upon a previously determined net asset value could permit a speculator to take advantage of fluctuations in the prices of the fund's underlying securities that occurred after the fund last calculated its net asset value.<sup>4</sup> The proposed program is fully consistent with this aim, as purchases of fund shares will be effected at the next computed price upon receipt of the order by AESC. There is no opportunity in the process for speculation by investors. To participate in the proposed program, investors will choose the convenience of purchasing mutual funds and paying Charge Card balances by writing a single check to TRS. Because the marketing materials prepared and distributed by AESC will fully disclose the mechanics of this arrangement, Cardmembers will be informed that pricing of their mutual fund purchases will occur when their order is received by AESC and not when payment is received by TRS.

#### VIII. Analysis of the Broker-Dealer Registration Issue

Because of the safeguards and the ministerial nature of TRS's activities as a processing agent, we submit that neither TRS nor any of its employees or affiliates (other than AESC) are required to register with the Commission as broker-dealers under Section 15(b) of the Exchange Act in connection with this proposal.

Section 3(a)(4) of the Exchange Act defines a "broker" as any person, other than a bank, "engaged in the business of effecting transactions in securities for the account of others." Section 3(a)(5) of the Exchange Act defines a "dealer" as any person,

<sup>4</sup> Investment Company Act Release No. 3319, October 19, 1968.

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September 8, 1998  
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other than a bank, "engaged in the business of buying and selling securities for his own account, through a broker or otherwise". Section 15(a) of the Exchange Act provides that "it shall be unlawful for any broker or dealer to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security, unless the broker or dealer is registered in accordance with Section 15(b)." (emphasis added)

Both the Commission staff and the NASDR have long concluded that an entity or person is not "effecting transactions" in securities if it is merely carrying out a clerical or ministerial function. See Aetna Casualty and Surety Company, 1988 SEC No-Action Letter, LEXIS 386 (pub. avail. Dec. 21, 1987); Chubb Securities Corporation, 1993 SEC No-Action Letter, LEXIS 1204 (pub. avail. Nov. 24, 1993); Applied Financial Systems, 1971 SEC No-Action Letter, LEXIS 4075 (pub. avail. Sept. 25, 1971); Dreyfus Group Equity Fund, 1971 SEC No-Action Letter, LEXIS 1000 (pub. avail. Jun. 26, 1971). See also Exchange Act section 3(a)(18) (defining the term associated person of a broker or dealer to exclude those persons who perform purely clerical or ministerial acts); NASDR By-Laws, Persons Exempt from Registration, Rule 1060(a)(1) (providing that "persons associated with a member are not required to be registered if their functions are solely and exclusively clerical or ministerial").

TRS's activities as a mere processing agent clearly fall within the activities which the staff has previously held to be purely clerical or ministerial in nature. The only function of TRS with respect to the securities business is to collect and promptly transfer periodic investment amounts to AESC in the interest of convenience and at the direction of the Cardmember.

As described above, AESC, a registered broker-dealer, will be responsible for all marketing activities related to TRS's proposed processing arrangement as well as for the underlying products and services offered by AESC. TRS will not advertise its role as a processor of Cardmembers' investment payments to AESC. AESC will have exclusive responsibility for the opening of accounts, the entering of orders, the execution of transactions, transferring investment monies to the appropriate mutual fund companies, and distributing account confirmations and statements. TRS will engage in none of these securities-related activities. Rather, TRS will restrict its activities to the ministerial tasks of loading envelopes into processing machines which will electronically enter the intended investment amount into TRS's payment processing system and promptly forward such payment to AESC. AESC is responsible for responding to all Cardmembers' securities-related questions and service issues. TRS employees and unregistered affiliates will be strictly prohibited from recommending, endorsing, responding to questions or engaging in any negotiations involving brokerage accounts or related securities transactions.

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Mr. Scheidt  
September 8, 1998  
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Moreover, the extensive internal safeguards offered by TRS provide abundant protection against risk of loss to Cardmembers and their intended investment amounts.

In light of the extensive safeguards proposed by TRS as well as the ministerial nature of TRS's role as a processing agent and AESC's role as the registered broker-dealer, TRS should not be required to register as a broker-dealer. While several SEC no-action letters lend strong support to our conclusion, the Aetna Casualty and Surety no-action letter, *supra*, is particularly applicable because it involved a processing arrangement similar to the one proposed by TRS. Although TRS is not a state licensed insurance company like Aetna, the circumstances and underlying rationale are much the same.

Just as TRS is seeking to extend the Charge Card's use as a bill paying mechanism to include voluntary payments for mutual funds, Aetna sought to extend its authorized check plan (the Aetna Service Account) to include payments for variable life insurance policies, a securities product like the mutual funds in this case. Aetna's proposal allowed customers, who had more than one insurance and variable life insurance policy to send a single monthly payment to Aetna, an entity not registered as a broker-dealer. Aetna, in turn, would process and allocate premiums on variable life insurance policies as well as on casualty and property insurance. The staff granted Aetna's no-action request concluding that Aetna, as a mere conduit of funds, was only engaged in clerical and ministerial activities.

The same rationale should apply with equal force to TRS's proposal. TRS, like Aetna, is an unregistered entity, although one that is subject to detailed regulation as a result of its participation in a regulated industry.<sup>7</sup> TRS, like Aetna, proposes to effectively limit its role to that of a conduit which collects and promptly transfers investment monies to a registered broker-dealer. The TRS proposal, like the Aetna proposal, protects investors from risk of loss inherent in any breakdown during the transfer process. In addition, the regulatory requirements and responsibilities imposed on AESC as a registered broker-dealer and the contractual restraints and strict limitations imposed on TRS as a processing agent so greatly minimize any risk to the public that no purpose would be served by subjecting TRS to the

<sup>7</sup> TRS must comply with the strict statutory requirements of the Consumer Credit Protection Act, including Section 226.10 (Prompt Crediting of Payments) of Regulation Z promulgated thereunder. TRS' compliance with such Act and related regulation is enforced by the Federal Trade Commission.

Ms. McGuire  
Mr. Scheidt  
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regulatory authority of the Commission. Therefore, the staff's conclusion that Aetna would not have to register as a broker-dealer applies directly to TRS.<sup>6</sup>

On several other occasions, the staff has agreed that broker-dealer registration is unwarranted when entities and/or persons perform clerical and ministerial services similar to the kind of processing arrangement proposed by TRS. See Carlos M. Urrutia, 1980 SEC No-Action Letter, LEXIS 3729 (pub. avail. Sept. 26, 1980) (taking and transmitting orders for securities, determined to be a clerical and ministerial service); Dreyfus Group Equity Fund, SEC No-Action Letter, Lexis 1000 (pub. avail. Jun. 26, 1971) (maintaining shareholder records, processing investments and redemptions of mutual fund shares, data processing, and mailing shareholder information determined to be clerical and ministerial services). Like the entities involved in the foregoing no-action letters, TRS, as a bill processing agent, will perform a purely clerical and ministerial task and therefore will not effect securities transactions or otherwise engage in securities-related activities.

Historically, the staff has indicated a concern when non-registered entities become engaged in marketing activities<sup>7</sup> or enter into compensation arrangements based on securities transactions.<sup>8</sup> TRS has responded to the staff's historical concerns by ensuring that none of its activities involve, or even approach, the functions that are the hallmark of broker-dealer activity. TRS will not engage in any marketing activities related to its proposed processing arrangement or the underlying securities products that can be purchased through the service. As a result, the staff should conclude that TRS is not required to register as a broker-dealer for engaging in limited processing activities for AESC at the direction of Cardmembers.

<sup>6</sup> This result is not affected by the fact that investors may send a check payable to TRS that will include payment for mutual funds because TRS, as a mere conduit, will not have control of investment monies. See Aetna No Action Letter, *supra*, where the staff agreed that "no control of customer's funds by Aetna exists, even if Aetna has momentary possession of these funds...because Aetna handles the funds only pursuant to customers' directions to transfer them...."

<sup>7</sup> See Lincoln Financial Advisors Corporation, SEC No-Action Letter, Lexis 303 (1998) (the staff refused to take a no-action position where Lincoln sought to enter into arrangements with certain insurance companies and their affiliated agencies through which insurers and agencies would become actively and intimately involved in selling mutual funds).

<sup>8</sup> See George T. Baylor, SEC No-Action Letter, 1971 SEC No-Action Letter, Lexis 3245 (Sept. 3, 1971) (the staff issued a negative response to a proposal to establish a restaurant containing telephone lines to brokerage houses, where the restaurant would receive a transaction-based payment from those brokerage houses).

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Mr. Scheldt  
September 8, 1998  
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**IX. Conclusion**

On the basis of the foregoing, we submit that TRS's role is not as an underwriter, dealer or other person designated by a fund to consummate transactions in its shares, but as the mutual fund purchaser's agent in the payment process. As such, the pricing requirements of Rule 22c-1 should not be triggered upon receipt of the payment by TRS, but at the point the order reaches AESC.

We further submit that since TRS's role is restricted to the ministerial task of collecting the intended investment and promptly remitting it to AESC in the interest of convenience and at the direction of the Cardmember, TRS should not be required to register as a broker-dealer under Section 15(b) of the Exchange Act.

We would like to meet with you and/or the appropriate members of your staff in the near future to discuss this matter. I will call you in the next couple of days to schedule the meeting. If you have any questions in the meantime, please feel free to contact me at (612) 671-8626.

Sincerely,

  
Colleen Curran

cc: Jack Drogin  
Anna Jacob

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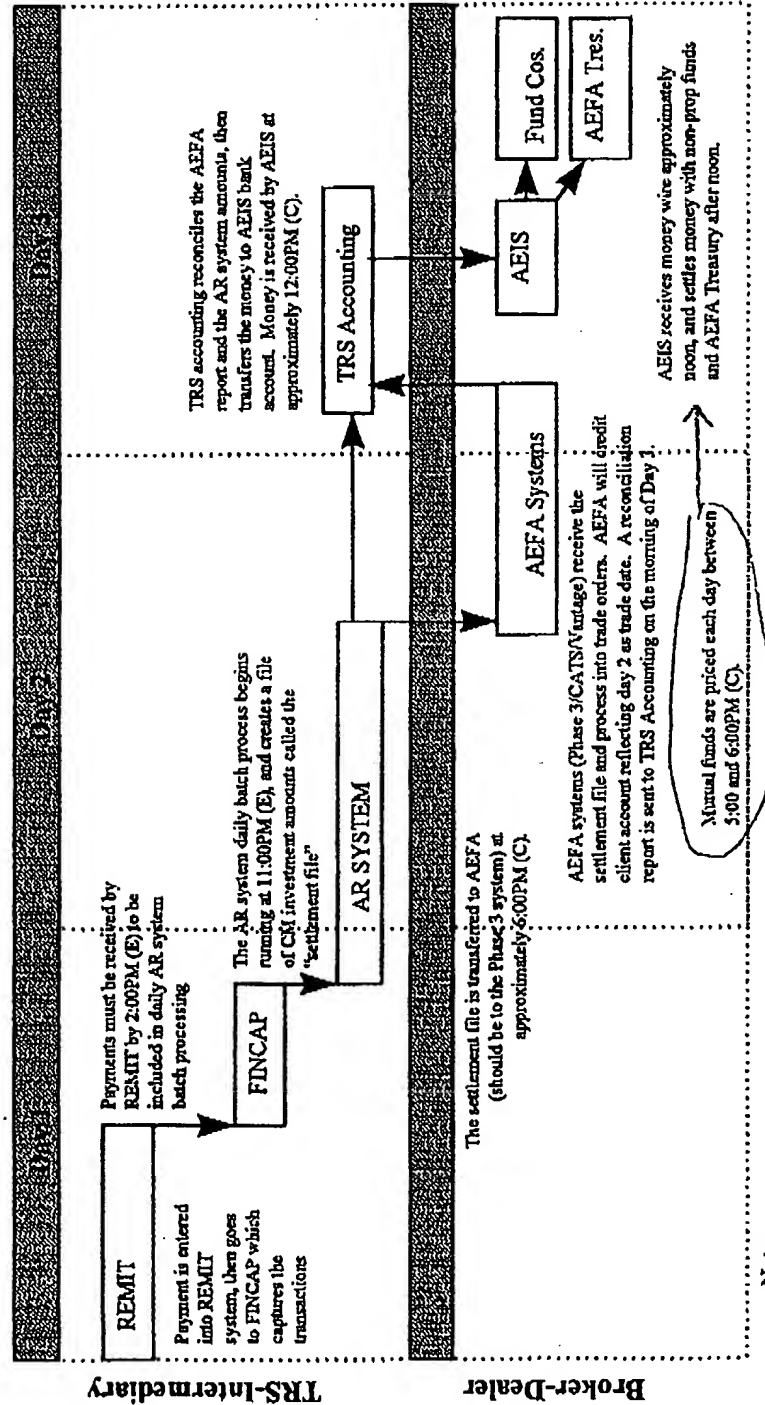
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# Investing on the Card Data and Money Flow

*Note: this flow process needs to be verified.*



## Notes:

- Payments received after 2:00 by REMIT are considered on the next business day.
- AEFA receives the settlement file on BD day one at about 6:00PM (C), but this can be earlier or later by a couple of hours. Approximately 6-10 times per year the file is one day late.

# **EXHIBIT 31**

# memorandum

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VB-34

September 11, 1998

TO: Sheri Beck  
Bob Elconin  
Rockell Metcalf

FROM: Colleen Curran *CC*

RE: Investing on the Card Strategy

I would like your comments on the attached memo regarding Investing on the Card by the end of the day on Monday. Sorry about the short turnaround time, but I would like your comments before I go to Gordon and Richard. I ran this strategy by Dick Phillips, except for the trade association stuff, and he gave several suggestions that I incorporated into the memo. I've put a call into the SEC to set up a meeting, but only talked to voicemail. Thanks again for your help.

#87309



# memorandum

---

September 11, 1998

TO: Dave Hubers  
Brian Kleinberg  
Louise Parent

CC: Sheri Beck  
Gordon Eid  
Bob Elconin  
Rockell Metcalf  
Richard Starr

FROM: Colleen Curran

RE: Strategy for Investing on the Card

As you know, we are about to start round 2 with the SEC regarding Investing on the Card. We believe our revised position makes an even stronger case for SEC approval. At the same time, we know the SEC will be breaking new ground by granting our no-action request. Given the importance of success with the SEC to our business partners, I would like your ideas about the following proposed strategy for working with the SEC. I have discussed this strategy with my GCO and Government Relations colleagues and Dick Phillips of Kirkpatrick & Lockhart and they concur.

1. Meet with the SEC staff. We are going to meet with lower level SEC staff so that we have an opportunity to learn the staff's concerns before facing more senior level staff. We are going to include Dick Phillips in that meeting. Dick's presence demonstrates the importance of this project.
2. Meet with senior SEC staff. If we are unable to persuade the lower level SEC staff, we are going to ask to meet with the senior SEC staff, at the Director level. Again, Dick Phillips would be at that meeting.
3. Dave/Harvey contact with Chairman Levitt. If we are unable to persuade the senior SEC staff, we may want Dave and/or Harvey to contact Chairman Levitt to discuss the policy reasons supporting our position. In my days at the SEC, this would be a highly unusual circumstance, with potential for significant harm to our ongoing relationships with the SEC. Chairman Levitt, however, seems to be open to contact by the industry. We would still need to carefully orchestrate any such conversations to avoid damage to our relationships with the SEC staff. We would advise Dave and/or Harvey to focus on the policy issues and would not recommend that they contact Chairman Levitt if the SEC staff was concerned about technical legal issues.

4. Contacts with Trade Associations. We do not believe it would be helpful to our cause to involve the trade associations in our discussions with the SEC. We have already influenced the ICI to specifically carve out an exception for charge cards in their letter to the SEC raising concerns about the use of credit cards to purchase mutual funds. We would expect that neither the SIA nor ICI would be interested in pursuing our position because of its uniqueness in the industry.

#87308

# **EXHIBIT 32**



VB-34

October 1, 1998

American Express  
General Counsel's Office  
World Financial Center  
New York, NY 10285

VIA FACSIMILE

Mr. Jack Drogin  
Division of Market Regulation  
Securities and Exchange Commission  
SEC Stop 7-10  
450 5<sup>th</sup> Street, N.W.  
Washington, D.C. 20549

Dear Mr. Drogin:

I have attached for your review a copy of Section 226.10 (Prompt Crediting of Payments) of Regulation Z, under the Consumer Credit Protection Act (the "Act"). American Express Travel Related Services Company's ("TRS") compliance with the Act is enforced by the Federal Trade Commission. I have also attached the Official Staff Commentary of the Federal Reserve Board on Section 226.10's Prompt Crediting of Payments requirement. This federal regulation is a compelling example of how TRS must handle customer funds carefully and responsibly.

We will also submit a supplemental memorandum discussing the overall federal and state regulatory regime which governs TRS.

We look forward to having the opportunity to meet you and discuss these issues in your offices. Please call me at 212-640-5760 if you have any questions.

Sincerely,

Rockell Metcalf  
Vice President &  
Group Counsel

cc: Colleen Curran  
Sheri Beck  
Anna Jacob

F

AMERICAN EXPRESS COMPANY  
GENERAL COUNSEL'S OFFICE  
AMERICAN EXPRESS TOWER  
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(612) 671-3767

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## Facsimile

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To: Mr. Jack Drogin  
Division of Market Regulation  
Securities & Exchange Commission  
Fax No: 202 942-9645

From: Rockell Metcalf  
VP & Group Counsel  
Fax No: 212 619-7099  
Tel. No: 212 640-5760

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Pages: 5 (including cover)

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# **EXHIBIT 33**

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*Michael L. Kelly, Esq.*  
*Snell & Associates*  
*802-382-8070*

From:

Patrice Jacobson  
Manager - Technology Contracts  
General Counsel's Office  
49th Floor

Pages:

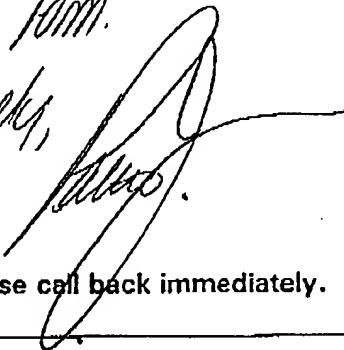
Date:

*10/22/98*  
*14*

Message:

*Michael - Per my voice mail - attached is information relating to Investing on the Card. I will also forward the Disclosure form to Colleen Cernan so she has it and can fill it out. After all I will be talking about the importance of this form.*

*Sincerely,*



If you do not receive all the pages, please call back immediately.

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# **EXHIBIT 34**

VB-34

## **AGENDA FOR NOVEMBER 3, 1998**

### **Meeting with the SEC Staff**

- I. INTRODUCTION
  - A. Background  
C. Curran
  - B. Kirkpatrick & Lockhart's Involvement and Support  
D. Phillips
- II. THE MONEY FLOW PROCESS  
R. Metcalf
- III. THE REGULATION OF TRS'S CARD BUSINESS  
R. Metcalf
- IV. THE BROKER-DEALER REGISTRATION ISSUE  
D. Phillips, R. Metcalf
- V. THE RULE 22c-1 PRICING ISSUE  
S. Beck, D. Phillips
- VI. PUBLIC POLICY  
C. Curran



November 3, 1998  
Meeting with SEC Staff  
Regarding  
TRS' Proposed Processing Arrangement

Attendees: S. Beck  
C. Curran  
J. Drogin  
A. Jacob  
P. Jensen  
C. McGuire  
K. McMillan  
R. Metcalf  
R. Phillips

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  - D. Public Policy**
- III. THE SUPPORTING SEC NO-ACTION LETTERS**
  - A. AETNA Casualty and Surety Company, SEC No-Action Letter, LEXIS 386 (pub. avail. Dec. 21, 1987)**
  - B. Dreyfus Group Equity Fund, SEC No-Action Letter, LEXIS 1000 (pub. avail. June. 26, 1971)**
  - C. Patrick Badamy, M.D., SEC No-Action Letter, LEXIS 1495 (pub. avail. Apr. 7, 1972)**
  - D. Consolidated Programs, Inc., SEC No-Action Letter, LEXIS 1771 (pub. avail. Mar. 22, 1973)**
- IV. A MEMORANDUM DETAILING THE STRICT REGULATION OF TRS' CARD BUSINESS**
- V. A COPY OF SECTION 226.10 (PROMPT CREDITING OF PAYMENTS) OF REGULATION Z**

**AGENDA FOR NOVEMBER 3, 1998**  
**Meeting the SEC Staff**

**I. INTRODUCTION**

A. Background  
**C. Curran**

~~B. Kirkpatrick & Lockhart's Involvement and Support~~  
~~**D. Phillips**~~

**II. THE MONEY FLOW PROCESS**  
**R. Metcalf**

**III. THE REGULATION OF THE TRS'S CARD BUSINESS**  
**R. Metcalf**

**IV. THE BROKER/DEALER REGISTRATION ISSUE**  
**D. Phillips, R. Metcalf**

**V. THE RULE 22c-1 PRICING ISSUE**  
**S. Beck, D. Phillips**

**VI. PUBLIC POLICY**  
**C. Curran**

## I. THE ISSUES HIGHLIGHTED

### A. Introduction

American Express Service Corporation ("AESC") would like to use American Express Travel Related Services Company, Inc. ("TRS") as a processing agent which collects and promptly remits to AESC Cardmembers' voluntary, periodic payments for mutual fund shares or variable annuity products.

### B. The Broker-Dealer Registration Issue

TRS should not be required to register as a broker-dealer because:

- TRS will be merely acting as a collection agent, whose function is solely clerical and ministerial. TRS's activities will be limited to the ministerial tasks of loading envelopes into a processing machine which will electronically process and promptly forward Cardmembers' investment amounts to AESC. See the attached copies of AETNA Casualty and Surety Company, 1988 SEC No-Action Letter, LEXIS 386 (pub. avail. Dec. 21, 1987) and Dreyfus Group Equity Fund, 1971 SEC No-Action Letter, LEXIS 1000 (pub. avail. June 26, 1971), where the staff agreed that serving as a mere processing agent is purely clerical and ministerial in nature.
- TRS has carefully and thoughtfully designed its proposed processing arrangement so that Cardmembers will not be exposed to any risk of loss by using TRS as a processing agent for their investment amount.
- AESC will have exclusive responsibility for all functions which have historically been considered broker-dealer activities.

### C. The Rule 22c-1 Pricing Issue

Since TRS's role under the proposed arrangement is effectively limited to that of a processing agent, the pricing requirements of Rule 22c-1 should not be triggered upon receipt of payment by TRS, but at the point the order reaches AESC. See the attached copies of Patrick P. Badamy, M.D., SEC No-Action Letter, LEXIS 1495 (pub. avail. April 7, 1972) and Consolidated Programs, Inc., SEC No-Action Letter, LEXIS 1771 (pub. avail. Mar. 22, 1973), where the staff agreed that the pricing provisions of Rule 22c-1 would be triggered by receipt of an order by the mutual fund company or its designated bank and not upon receipt by the payment processing agent.

#### D. Public Policy

There are strong and compelling policy reasons for AESC's proposed processing arrangement with TRS:

- **INVESTOR PROTECTION**

Cardmembers who choose to use TRS's bill paying services to invest are protected by:

- Strict marketing and disclosure requirements
- Elaborate procedures designed to safeguard Cardmember funds
- Supervision of TRS activities by AESC
- Ultimate liability of AESC

In addition, Cardmembers are protected by the prompt crediting of payments and related rules of the Consumer Credit Protection Act, which are enforced by FTC for charge cards.

- **FUNCTIONAL REGULATIONS**

AESC is subject to extensive regulation by the SEC as a broker-dealer. TRS is subject to extensive regulation by the FTC as a charge card company. To require TRS to also be registered as a broker-dealer is too duplicative and unnecessary.

- **INVESTOR CHOICE**

For several years, Cardmembers, particularly those involved in the similar program for fixed annuities, have requested this processing arrangement because it gives them an additional choice in how they can invest and gain access to the securities markets.

- **INVESTOR FLEXIBILITY**

This processing arrangement gives more flexibility to the investor than a bank authorization or similar periodic plan. Investment contributions can increase or decrease monthly according to the investor's current financial situation.

- **INVESTOR CONVENIENCE**

This processing arrangement is convenient because it allows a Cardmember to send a single check for both regular Charge Card purchases and for the purchase of mutual fund shares. This ease of investing serves to encourage the public to invest and save.

- **DEMONSTRATED SAFETY AND EFFECTIVENESS**

For the past eight years, Cardmembers have made contributions to their fixed annuities. \$1.2 billion in fixed annuity premiums have been processed without a single complaint.

- **CHARGE NOT CREDIT**

This processing arrangement is limited to **charge cards** and does not involve an extension of credit to purchase securities since the broker-dealer only executes the trade after it receives the Cardmember's investment contribution.

**AETNA Casualty and Surety Company, SEC No-Action Letter, LEXIS 386 (pub. avail. Dec. 21, 1987)**

In the AETNA letter, the staff agreed that broker-dealer registration was unwarranted when AETNA served as a processing agent for variable life insurance policies. The staff concluded that investors were sufficiently protected from any risk of loss inherent in any breakdown during the transfer process.

2ND LETTER of Level 1 printed in FULL format.

1988 SEC No-Act. LEXIS 386

Securities Exchange Act of 1934 -- Section 15(a)

Jan 12, 1988

[\*1] Aetna Casualty and Surety Company

TOTAL NUMBER OF LETTERS: 2

SEC-REPLY-1: UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
December 21, 1987

George N. Gingold, Esq.  
Law Department  
The Aetna Casualty and Surety Company  
151 Farmington Avenue  
Hartford, Connecticut 06156

Dear Mr. Gingold:

This letter responds to your letter of September 11, 1987 on behalf of The Aetna Casualty and Surety Company ("Aetna"), in which you request assurance that the staff of the Division of Market Regulation will not recommend enforcement action if Aetna collects and allocates premiums for variable life insurance policies without being required to register as a broker or dealer under section 15(a) of the Securities Exchange Act of 1934 ("Exchange Act"). Based on the representations made in your letter and in our subsequent telephone conversations, I understand the facts to be as follows.

Two entities are chiefly involved. Aetna itself, a wholly-owned subsidiary of Aetna Life and Casualty Company, is a Connecticut insurance corporation engaged principally in the sale of all types of casualty and property insurance. Aetna markets this insurance, including automobile, homeowners, and various other types of personal [\*2] items coverage, directly to individuals.

The other entity, Aetna Life Insurance and Annuity Company ("ALIAC"), also is a Connecticut insurance corporation and a wholly-owned subsidiary of Aetna Life and Casualty Company. ALIAC is engaged principally in the sale of life insurance, health insurance, and annuity contracts. Among the contracts sold by ALIAC are registered variable annuity and variable life insurance contracts. ALIAC is registered as a broker-dealer under the Exchange Act for the purpose of selling these variable contracts, which it does directly through its own sales force and through other broker-dealers.

For its life insurance policies, ALIAC has had in the past administrative systems under which a customer could pre-authorize automatic withdrawals from a checking account to pay premiums at specified intervals. Under these arrangements ("authorized check plans" or "ACPS"), customers need not prepare and mail premium payments and the insurer can be certain of timely payment. A



1988 SEC No-Act. LEXIS 386, \*2

Page 4

separate customer authorization typically exists for each policy. Aetna recently has developed its own ACP, the Aetna Service Account ("ASA"), which permits a single monthly payment by [x1] a customer who has several policies with Aetna, ALIAC, or both, even though these policies have different premium due dates, durations, and renewal dates.

Aetna now proposes that payments of premiums due on ALIAC's registered variable life insurance policies be eligible for inclusion in ASA under the following circumstances. On the eighth day of each month, ALIAC produces an electronic billing record for ASA, which then merges the ALIAC billing record with casualty product billing records. The combined billing record is delivered to the Connecticut Bank and Trust Company ("CBT") in Hartford, Connecticut for processing through established banking channels.

*The Aetna Service Account merges the ALIAC billing record with Aetna's casualty billing records.*

On the fifteenth day of each month or, if the fifteenth falls on a weekend or a holiday, the next working day, CBT begins the collection process. On the day when the collection process begins, ASA proposes to transfer electronically to ALIAC the amount cited to CBT for collection. ALIAC proposes to apply these funds to each individual policy at the price next calculated following receipt of the electronic advice from ASA. You represent that, if insufficient funds are present within a customer's checking account to equal the [\*4] total amount due for all policies, the automatic withdrawal does not take place at all, so that Aetna is not forced to allocate available funds among the policies. ASA also proposes to initiate the billing process twice monthly, commencing on either the eighth or the twenty-second of each month. Each policy, however, will be eligible for inclusion in the billing cycle only once per month, and each customer will elect the cycle to be followed for each policy.

You conclude that broker-dealer registration would not be required for Aetna as a result of its involvement in this program, because its activities would be limited to those of a clerical and ministerial nature. In your opinion, no control of customers' funds by Aetna exists, even if Aetna has momentary possession of these funds through ASA, because Aetna handles the funds only pursuant to customers' directions to transfer them to ALIAC. You support this conclusion with two arguments.

*VOBY!*

First, customers' payments will be applied as quickly as they would have been had a transfer been made directly from the customers' checking accounts to ALIAC. Second, there will be no risk to the customer related to delay in transmission [\*5] and no risk of investment gain or loss from the time of transfer to the time of investment. This lack of risk accords with ALIAC's normal procedures, which involve the immediate processing of payments regardless of due date. If, for some unforeseeable reason, the second transfer from ASA to ALIAC failed to occur even after the first transfer from CBT to ASA, ALIAC nevertheless would apply the payments at the time and in the manner anticipated, as though the second transfer had timely occurred. As between ALIAC and the customer, ALIAC thus assumes the risk of loss inherent in any breakdown of the transfer process. You represent that receipt of customers' funds by Aetna through ASA will be deemed to be receipt of these funds by ALIAC, the broker-dealer responsible for the registered variable annuity and variable life insurance contracts.

You also represent that, for payments applied to premiums for registered variable life insurance policies through ASA, ALIAC will provide customers with

confirmations meeting the requirement of the Exchange Act, Rule 10b-10 thereunder, and a previous no-action letter from the Division of Market Regulation to ALIAC. n1 Each participating customer [\*6] also will receive a monthly bank statement reflecting all ASA withdrawals during the period covered by the statement; in addition, Aetna will provide customers with monthly statements of ASA activity. You conclude that customers effectively will receive two confirmations of Aetna's withdrawals from their accounts to pay premiums through ASA.

n1 Letter from Lynne G. Masters, Attorney, Office of Chief Counsel, Division of Market Regulation, SEC, to Michael Berenson, Esq., Finley, Kumble, Wagner, Heine, Underberg, Manley & Casey (Jan. 9, 1987) (Aetna Life Insurance and Annuity Company).

You further represent that Aetna has agreed to maintain records of ASA transactional activity regarding ALIAC's registered variable life insurance products in the form and for the duration required for broker-dealer books and records under section 17 of the Exchange Act and the rules thereunder, particularly Rules 17a-3 and 17a-4. Finally, you represent that Aetna's records of this ASA transactional activity will be deemed to be records of the broker-dealer ALIAC and that Aetna either will provide copies of these records to ALIAC for inspection by the appropriate regulatory authorities upon [\*7] request or will make these records available for inspection itself. You conclude that Aetna and ALIAC thus will provide the necessary audit trail to ensure that all securities transactions effected through ASA as described above are completed and confirmed in accordance with the requirement of the Exchange Act and the rules thereunder.

Based on the facts and representations set forth above, the staff will not recommend enforcement action if Aetna collects and allocates premiums for ALIAC's variable life insurance policies as you describe without registering as a broker or dealer under section 15(a) of the Exchange Act. This position concerns enforcement action only and does not express any legal conclusions on the applicability of the statutory or regulatory provisions of the federal securities laws. This position is based solely on the representations that you have made, and any different facts or conditions might require a different response.

Sincerely,  
John Polanin, Jr.  
Attorney  
Office of Chief Counsel  
(202) 272-2848

INQUIRY-1: Aetna Law Department  
151 Farmington Avenue  
Hartford, CT 06156  
(203) 273-4686  
September 11, 1987

Mr. Robert L. D. Colby, Chief Counsel  
Division of Market Regulation  
[\*8] Securities and Exchange Commission  
450 Fifth Street, N.W.

Washington, DC 20549

Re: The Aetna Casualty and Surety Company  
No-Action Request  
Status as Broker or Dealer under the 1934 Act

Dear Sirs:

We respectfully request the Division of Market Regulation ("Division") indicate it will not recommend enforcement action to the Securities and Exchange Commission against the Aetna Casualty and Surety Company ("Aetna"), if Aetna takes the steps described below without being required to register as a broker or as a dealer in accordance with Section 15(a) of the Securities Exchange Act of 1934 ("1934 Act").

Aetna, a wholly-owned subsidiary of Aetna Life and Casualty Company, is a Connecticut insurance corporation engaged principally in the sale of all types of casualty and property insurance. Aetna markets such insurance directly to individuals, including automobile, homeowners and various other types of personal items coverage.

Aetna Life Insurance and Annuity Company ("ALIAC") is also a Connecticut insurance corporation and a wholly-owned subsidiary of Aetna Life and Casualty Company. ALIAC is engaged principally in the sale of life insurance, health insurance and annuity contracts. [\*9] Among the contracts it sells are registered variable annuity and variable life insurance contracts; ALIAC is registered as a broker/dealer under the 1934 Act for the purpose of selling such variable contracts, both directly through its own sales force and through other broker/dealers.

ALIAC, with its life insurance policies, has had for years administrative systems under which a customer could pre-authorize automatic withdrawals from his or her checking account for the purpose of making premium payments at specified intervals. Such arrangements (called "authorized check plans" or "ACPs") are convenient both for the customer who does not have to prepare and mail premium payments, and to the insurer, which can be certain of timely payment. Typically, a separate authorization exists for each policy.

A few years ago, Aetna developed what it calls the Aetna Service Account ("ASA"). Essentially, the ASA ACP Plan permits a single monthly payment by the customer, even though the customer has multiple policies with Aetna, ALIAC or both, and even though those policies have different premium due dates. The existence of multiple policies with a single insurance company is quite common. [\*10] For example, automobile, homeowners and personal items coverages are three distinct types of coverage, and a given individual may have more than one automobile policy or one homeowners policy. These policies may be for different durations and have different renewal dates; the desirability of a combined payment facility, from the standpoint both of insurer and insured, is self-evident.

Many Aetna customers also own life insurance policies issued by ALIAC, as well as casualty policies issued by other Aetna companies. ASA provides that a single periodic payment made by the customer could be applied to pay premiums on life insurance policies as well as on automobile, homeowners and other

casualty-property policies. To date, however, ASA has not been extended to cover variable life insurance policies, interests in which are required to be registered under the Securities Act of 1933 and sold by a registered broker/dealer. It is the latter possibility which is the subject of this letter.

In ASA, the vast majority of payments are to cover premiums which will become due on automobile, homeowners and other casualty-property policies. It is in that area where multiple policy ownership [\*11] most often makes the establishment of a payment facility such as ASA mutually advantageous to insurer and insured. This administrative service has worked well for a small volume of nonregistered life insurance policies. No purpose would be served by requiring a separate ASA facility for registered products.

We propose that ALIAC's variable life insurance policies be eligible for inclusion in ASA under the following circumstances. On the eighth day of each month ALIAC produces an electronic billing record for ASA. ASA then merges the ALIAC billing record with casualty product billing records. The combined computer billing record is then delivered to Connecticut Bank and Trust Company ("CBT"), Hartford, Connecticut for processing through established banking channels. On the 15th day of each month or, if the 15th falls on a weekend or holiday, the first working day thereafter, CBT begins the collection process. On the day the collection process begins ASA proposes to electronically transfer to ALIAC the amount cited to CBT for collection. ALIAC proposes to apply the funds to each individual policy at the price next calculated following receipt of the electronic advice from [\*12] ASA. ASA proposes to initiate the billing cycle twice monthly, commencing on either the 8th or the 22nd of the month. However, each policy will be eligible for inclusion in the billing cycle only once per month. The customer will elect the cycle in which each policy is to be included.

Two facts are central in the analysis. First, the purchase payment will be applied as quickly as it would have been had a transfer been made directly from the customer's checking account to ALIAC. Second, there are no questions related to delay in transmission, and no question of who bears the risk of investment gain or loss from the time of transfer to the time of investment. This accords with ALIAC's normal procedures, which involve the immediate processing of purchase payments regardless of the due date.

Under the proposed extension of ASA to registered life insurance products, Aetna would act only as a conduit. ~~Because the transfer from Aetna to ALIAC is as nearly simultaneous as practicable with the transfer from the customer's checking account to Aetna, Aetna would not possess customer funds for any measurable period of time. If for some unforeseeable reason the second transfer failed [\*13] to take place even after the first one was made, ALIAC would nevertheless apply the purchase payment at the time and in the manner anticipated as though the second transfer had taken place on a timely basis. As between ALIAC and the customer, ALIAC assumes the risk of loss inherent in any breakdown in the transfer process.~~

~~No control of customer fund by Aetna exists, even if there is momentary possession, because Aetna handles such funds only in accordance with customer directions that there be a transfer to ALIAC. Such limited involvement by Aetna is in our judgment clerical and ministerial. See Applied Financial Systems,~~

Inc. (available August 27, 1971).

For purchase payments applied to the purchase of a registered security under ASA, ALIAC will provide customers with annual confirmations meeting the requirements of the 1934 Act, Rule 10b-10 thereunder, and a previous "no-action" letter from the Division to ALIAC. In addition, the customer will receive a monthly bank statement reflecting all ASA account withdrawals during the period covered by the statement, and Aetna will provide monthly statements of ASA account activity. In substance, then, customers will receive [\*14] two confirmations of Aetna's withdrawals to make premium payments through ASA.

As a condition of receiving the requested no-action relief, Aetna has agreed to maintain records of ASA transactional activity regarding registered products in the form and for the time period required for broker/dealer books and records under Section 17 of the 1934 Act. Aetna will either provide copies of such records to ALIAC for inspection by appropriate regulatory authorities upon request, or itself make those records available for inspection. By so doing, Aetna in conjunction with ALIAC will provide the necessary audit trail to make certain that all securities transactions are completed and confirmed in accordance with 1934 Act requirements.

In analogous contests, it appears that no-action positions have previously been taken where a financial institution's role was essentially that of a conduit of funds in securities transactions. See, for example, Fidelity Distributors Corp. (available July 13, 1986), Boston Mutual Life Ins. Co. (available January 13, 1972).

In conclusion, we respectfully request that the staff of the Division not recommend that any enforcement action be taken against [\*15] Aetna for failure to register as a broker or dealer under the 1934 Act if it administers the ASA payment facility, particularly with regard to registered securities products, in the manner described in this letter, and if books and records are maintained as described herein.

If you have any questions, please feel free to call the undersigned.

Very truly yours,  
George N. Gingold  
Counsel

**Dreyfus Group Equity Fund, SEC No-Action Letter, LEXIS 1000  
(pub. avail. Jun. 25, 1971)**

In the Dreyfus letter, the staff agreed that broker-dealer registration was unwarranted when Bradford Computer Systems performed clerical and ministerial tasks such as processing investments and redemptions of mutual fund shares, maintaining shareholder records, data processing and mailing shareholder information.

49TH LETTER of Level 1 printed in FULL format.

1971 SEC No-Act. LEXIS 1000

Securities Exchange Act of 1934 - Section 15

Jun 26, 1971

(\*1) The Dreyfus Group Equity Fund, Inc.

TOTAL NUMBER OF LETTERS: 2

SEC-REPLY-1: May 28, 1971

Lawrence M. Greene, General Counsel  
The Dreyfus Corporation  
767 Fifth Avenue  
New York, New York 10022

Dear Mr. Greene:

In your letter dated May 24, 1971, you refer to correspondence with this office and request our concurrence in your opinion that Bradford Computer & Systems, Inc., or its subsidiary, Bradford Mutual Fund Services, Inc. ("Bradford"), may perform services for The Dreyfus Group Equity Fund, Inc. ("the Fund"), without broker-dealer registration.

You state that it is contemplated that Bradford will process investments and redemptions and maintain shareholder records for the Fund and that Bradford will only render services which are "clerical" or "ministerial" in nature, such as data processing, mailings to shareholders, answering shareholder inquiries with respect to accounts, etc. You state that checks for investments may be transmitted to Bradford for record keeping convenience but will be payable to the Bank of New York (the "Bank"), as custodian or to the Fund. Redemption requests will be processed through Bradford but redemption payment will be made by the Fund, the Bank or the underwriter, Dreyfus Sales (\*2) Corporation

On the basis of your representations that Bradford will not render any services to the Fund other than these of a clerical or ministerial nature, we will not raise any objection because Bradford is not registered as a broker-dealer.

You understand, of course, that this is a staff position, and that it applies only to the arrangement between Bradford and the Fund. The fact that we have indicated that we will not raise any objection or recommend any enforcement action on the basis of the particular facts in this case, should not be understood or construed to be an interpretation that such proposed activity would be in accord with applicable statutory or regulatory provisions.

Sincerely,

Michael Saperstein  
Assistant Chief Counsel

1971 SEC No-Act. LEXIS 1000, \*2

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INQUIRY-1: THE DREYFUS CORPORATION  
MANAGERS OF THE DREYFUS FUND INCORPORATED  
THE DREYFUS LEVERAGE FUND INC.  
767 FIFTH AVENUE  
NEW YORK, N.Y. 10022  
935-9300 TELETYPE: 710-581-2755

May 24, 1971

Ezra Weiss, Esq.  
Chief Counsel  
Division of Trading and Markets  
Securities and Exchange Commission  
500 North Capitol Street, N.W.  
Washington, D.C. 20549

Re: The Dreyfus Group Equity Fund, Inc.  
File No. 2-33733

Dear Mr. Weiss:

In further reference [\*3] to the proposed engagement of Bradford Computer & Systems, Inc., or its subsidiary, Bradford Mutual Fund Services, Inc., to process investments and redemptions and maintain shareholder records for The Dreyfus Group Equity Fund, Inc., it is contemplated that Bradford will only render service of a clerical, administrative or ministerial nature, such as data processing, mailings to shareholders, answering inquiries regarding shareholder accounts, and similar matters.

Checks for investments to be made in share of The Dreyfus Group Equity Fund, Inc. may be transmitted to Bradford for record keeping convenience but will be made out to The Bank of New York, as custodian, or The Dreyfus Group Equity Fund, Inc. Such checks will be forwarded promptly to the Bank, as custodian. Redemption requests will be processed through Bradford since it maintains all shareholder records, but redemption payments will be made by the Fund, the Bank, or The Dreyfus Sales Corporation, as underwriter.

In the light of the foregoing and in line with your opinion, we believe that the proposed procedure will not require any broker/dealer registration.

Sincerely yours,

Lawrence M. Greene  
General Counsel



**Patrick P. Badamy, M.D., SEC No-Action Letter, LEXIS 1495  
(pub. avail. Apr. 7, 1972)**

In the Badamy letter, the staff recognized that a custodian or trustee under a Keogh Plan does not function as a dealer, underwriter, or fund designee as set forth in Rule 22c-1, but instead as the mutual fund purchaser's agent. As a result, Rule 22c-1 would apply at the fund, underwriter or fund designee level. The staff specifically addressed the fact that payment processing agents would be recommended by a fund and determined that such a recommendation would not change the analysis.

10TH LETTER of Level 1 printed in FULL format.

1972 SEC No-Act. LEXIS 1495

Investment Company Act of 1940 - § 22(c) - Rule 22c-1

Apr 7, 1972

(\*1) Patrick P. Badamy, M.D.

TOTAL NUMBER OF LETTERS: 2

SEC-REPLY-1: Rule 22c-1 under the Investment Company Act of 1940, generally requires that an order for fund shares be priced at the price next computed after receipt of the order by the fund, principal underwriter, dealer or other person authorized to consummate transactions for them. However, if you engage the Keogh custodian or trustee without any recommendation from the fund or its principal underwriter, such custodian or trustee is your agent not the fund's and what it does is a matter of private contract or understanding between you. Even if the Keogh custodian or trustee is one recommended by the fund or its principal underwriter, such custodian or trustee is arguably agent for the purchaser and not the fund. In any event, we have not objected if a custodian or trustee recommended by a fund or its principal underwriter makes the purchase within a reasonable time after receipt, e.g., two business days. You should ask your Keogh custodian or trustee what its practice is.

Alan Rosenblat, Chief Counsel  
Division of Corporate Regulation

February 29, 1972

INQUIRY-1: PATRICK P. BADAMY, M.D.  
175 COOPER RDAD  
ROCHESTER 17, NEW YORK  
CONGRESS 6-0029

Feb 8, 1972

(\*2)

Securities and Exchange Commission  
Washington, D.C.

Dear Sir:

When one buys a Fund under the Keogh Plan isn't it purchased the day that a check is given and a order is executed? Isn't it teletyped in? Could it be executed at a price for that day it was purchased?

Very truly yours,

Patrick P. Badamy, M.D.

**Consolidated Programs, Inc., SEC No-Action Letter, LEXIS 1771  
(pub. avail. Mar. 22, 1973).**

In the Consolidated Programs, Inc. ("CPI") letter, the staff issued assurances with respect to CPI's proposal to act as agent for individual mutual fund purchasers, receiving their payments for fund share purchases through a computerized billing system and forwarding them to the fund's designated bank. Under CPI's proposal, customers would receive the fund share price next computed after receipt by the fund's bank (22c-1 applied at the bank, not at CPI).

1ST LETTER of Level 1 printed in FULL format.

1973 SEC No-Act. LEXIS 1771

Investment Company Act of 1940 - § 22(c) - Rule 22c-1

Mar 22, 1973

[\*1] Consolidated Programs, Inc.

TOTAL NUMBER OF LETTERS: 2

SEC-REPLY-1: Without necessarily agreeing with all aspects of your legal reasoning, based on the foregoing we will not recommend that the Commission take any action in connection with CPI's proposed computerized billing system, provided that CPI proceeds in reliance on your opinion as counsel that the foregoing arrangement will not violate Section 22(c) of the Investment Company Act of 1940 nor Rule 22c-1 thereunder.

Peter M. Sullivan, Attorney  
Division of Investment Management  
Regulation

FEB 22, 1973

INQUIRY-1: BUTLER, BINION, RICE, COOK & KNAPP  
ATTORNEYS AT LAW  
[ BUILDINGS  
HOUSTON, TEXAS 77002

August 30, 1972

Securities and Exchange Commission  
500 North Capitol Street Northwest  
Washington, D.C. 20549

Re: Consolidated Programs, Inc.

Gentlemen:

This letter and the requests contained in it are submitted on behalf of our client, Consolidated Programs, Inc. ("CPI").

I.

Facts

Identity of CPI. CPI is a Texas corporation headquartered in Houston, Texas. It is registered as a broker and dealer in securities under the Securities Exchange Act of 1934, as amended, and is a member of the National Association of Securities Dealers, Inc. [\*2]

The CPI Billing System. CPI has devised a computerized billing system (the "CPI Billing System") to be used in receiving and disbursing, as instructed,

1973 SEC No-Act. LEXIS 1771, \*2

Page 4

moneys from individual clients. The CPI System would be used in connection with, but would not be limited to, combined life insurance and mutual fund purchase programs. It is contemplated that moneys would be disbursed to any "qualified recipient" designated by a client. A qualified recipient would be any institution (typically but not necessarily an insurance company or mutual fund custodian) which had entered into an agreement governing the handling or use of money directed to it. It is expected that certain insurance companies affiliated with CPI would be among such qualified recipients. CPI is not presently affiliated with any mutual fund advisor or custodian.

The CPI Billing System would utilize two methods of collecting funds from clients: the "bank draft" method and the "list bill" method.

Under the bank draft method of collection, a check preauthorized by the client would be drawn on the fifth or twentieth day of each month and deposited with the designated qualified recipient.

Under the list bill method of [\*3] collection, CPI would prepare a group billing on the fifth or twentieth day of each month and mail it to the employer of the client, who in turn would remit payment on behalf of all of its employees who were clients of the CPI Billing System. List bill arrangements would be entered into only with employers of a number of clients sufficiently large to make the relationship practical from the standpoint of CPI.

All moneys received by CPI under either of the foregoing collection methods would be transmitted as instructed by the client to the appropriate qualified recipient not later than the close of the business on the day following the day on which such funds were received by CPI. It is contemplated that such transmittal would be by mail. In the case of moneys intended for the purchase of mutual fund shares, the price paid by the customer would be that next computed by the custodian bank after receipt thereof by the custodian bank, as required by Reg. Sec. 270.22c-1 under the Investment Company Act of 1940, as amended ("Rule 22c-1").

II.

#### Requested "No Action" Letter

The purpose of this letter is to inquire as to whether the Staff of the Commission believe that anything [\*4] in the foregoing arrangement would violate Rule 22c-1. Subject to the concurrence of the Staff as requested below, it is our opinion that no violation of the foregoing Rule would be incurred, assuming that each mutual fund custodian bank receiving moneys from any client of CPI would following such receipt comply with Rule 22c-1. This conclusion is based on our understanding that CPI would be acting as agent for its individual clients and would be compensated by its individual clients (or by their employers) and would be performing essentially ministerial duties for its clients in collecting and disbursing their moneys as instructed by them. Any client of CPI would be informed as to the processing time involved in the CPI Billing System.

It is requested that the Staff indicate whether they concur in the conclusions expressed above and whether it is contemplated that the Commission would take any action against CPI by reason of its putting into effect the CPI

1973 SEC No-Act. LEXIS 1771, \*4

Page 5

Billing System as described in this letter.

If any member of the Staff has any question, it is requested that he telephone me collect at (713) 224-6711 in Houston, Texas, or write me at the address indicated above. If a [\*5] personal conference with officers of CPI is desired, I will arrange such a meeting at the convenience of the Staff. The privilege of such a meeting is specifically requested in the event that it is concluded that an affirmative reply to the request for a "no action" letter cannot be given on the basis of this letter.

Yours very truly,

John Moore



## A MEMORANDUM DETAILING THE STRICT REGULATION OF TRS' CARD BUSINESS

This memorandum details the strict regulatory regime under which TRS operates its charge card business. It is submitted as compelling evidence of how TRS must conduct business and handle customer payments carefully and responsibly.

The primary set of federal laws pursuant to which TRS issues and operates its charge card business in the United States is the **Consumer Credit Protection Act** (15 U.S.C.A. §1601 et seq.)(the "Act"). The key provisions of the Act and its implementing regulations are enforceable against TRS, as issuer of the consumer charge card, by the Federal Trade Commission (the "FTC"). The FTC has direct regulatory authority to bring administrative enforcement proceedings against TRS for non-compliance with the Act, and civil money penalties may be imposed under proper circumstances.

The Act is comprised of the following laws:

1. **The Fair Credit Billing Act** (15 U.S.C.A. §1666 et seq.)(**"FCBA"**)

The FCBA contains provisions intended to assure the fair and prompt resolution of billing disputes in consumer credit, along with various other provisions. Significantly, it also contains the requirement that payments received from a consumer be posted promptly to the consumer's account (15 U.S.C.A. §1666c). This requirement is also contained, and expanded upon, in Section 226.10 of Regulation Z.

2. **Truth in Lending Act** (15 U.S.C.A. §1601 et seq.) (**"TILA"**)

The TILA's purpose is to promote the informed use of consumer credit by requiring disclosures about its terms and costs, and it also regulates various credit and charge card practices. It prescribes the content of disclosures to be made in customer agreements, periodic statements, etc.

3. **The Credit and Charge Card Disclosure Act** (15 U.S.C.A. §1637 inter alia)(**"CCCD"**)

The CCCDA amended the TILA by adding provisions requiring specific disclosures about credit and charge card plans in solicitations and applications for such plans. Its purpose was to enhance the level of information provided to consumers as they consider the purchase of a credit product.

4. **The Equal Credit Opportunity Act (15 U.S.C.A. §1691 et seq.)("ECOA")**

The ECOA prohibits discrimination against protected classes of persons in the extension of credit. Implementing regulations contain provisions intended to assure that prohibited bases are not taken into account at various stages of the credit life cycle (solicitation, application, account management, etc.).

5. **The Fair Credit Reporting Act (15 U.S.C.A. §1681 et seq.)("FCRA")**

The FCRA prescribes the circumstances under which a "consumer report" (as defined in the FCRA) can be obtained. It governs the core business of credit reporting agencies, imposing substantive obligations on both the agencies and the users of consumer reports.

6. **The Electronic Funds Transfer Act (12 U.S.C.A. §4001 et seq., 15 U.S.C.A. §1693)("EFTA")**

The EFTA establishes the rights of consumers in engaging in electronic funds transfers. It provides for various disclosures, as well as for dispute resolution procedures.

Numerous states contain similar consumer credit regulations as well which include laws against improper handling of remittances. Of course, federal law preempts any conflicting regulation at the state level.



~~SECTION 226.10—Prompt Crediting of Payments~~

SECTION 226.10—Prompt Crediting of Payments

(a) *General rule.* A creditor shall credit a payment to the consumer's account as of the date of receipt, except when a delay in crediting does not result in a finance or other charge or except as provided in paragraph (b) of this section.

AT ANY  
we have  
late  
charge  
so N/A.

(b) *Specific requirements for payments.* If a creditor specifies, on or with the periodic statement, requirements for the consumer to follow in making payments, but accepts a payment that does not conform to the requirements, the creditor shall credit the payment within five days of receipt.

(c) *Adjustment of account.* If a creditor fails to credit a payment, as required by paragraphs (a) or (b) of this section, in time to avoid the imposition of finance or other charges, the creditor shall adjust the consumer's account so that the charges imposed are credited to the consumer's account during the next billing cycle.

10(a) General Rule

1. *Crediting date.* Section 226.10(a) does not require the creditor to post the payment to the consumer's account on a particular date; the creditor is only required to credit the payment as of the date of receipt.

2. *Date of receipt.* The "date of receipt" is the date that the payment instrument or other means of completing the payment reaches the creditor. For example:

- Payment by check is received when the creditor gets it, not when the funds are collected.
- In a payroll deduction plan in which funds are deposited to an asset account held by the creditor, and from which payments are made periodically to an open-end credit account, payment is received on the date when it is debited to the asset account (rather than on the date of the deposit), provided the payroll deduction method is voluntary and the consumer retains use of the funds until the contractual payment date.
- If the consumer elects to have payment made by a third-party payor such as a financial institution, through a preauthorized payment or telephone bill-payment arrangement, payment is received when the creditor gets the third-party payor's check or other transfer medium, such as an electronic fund transfer, as long as the payment meets the creditor's requirements as specified under section 226.10(b).

# **EXHIBIT 35**

From: Colleen Curran @ IDS on 11/03/98 04:14 PM CST  
To: Louise Parent, Gordon Eid @ IDS, Brian Kleinberg @ IDS, David Hubers @ IDS, Nancy E Jones, Suzanne Crane @ IDS, John Cattau, Joel Allen @ IDS, Tom Joyce @ IDS, Tim Heine, Robert Kraus  
cc: Chip Jones @ IDS, Bob Elconin @ IDS (bcc: Rockell Metcalf)  
Subject: POSITIVE NEWS: UPDATE ON THE MEETING WITH THE SEC REGARDING INVESTING ON THE CARD

**Message from Colleen Curran, Sheri Beck and Rockell Metcalf**

We had a very positive meeting with the SEC. Dick Phillips, our outside counsel, said we couldn't have asked for a better meeting. At the end of the meeting, the SEC senior staff person said that Colleen, as the former deputy chief counsel, could come and meet with her any time.

The SEC complimented us on our presentation and seemed very respectful to working with us to find a way to approve our proposal. They understood the consumer benefits of IOTC. They said that our mutual fund pricing argument was "right on." The SEC continued to be concerned that TRS is not registered as a broker-dealer, with the primary focus on the financial responsibility.

We will contact several of you for additional information to respond to SEC questions. The senior staff person committed to contacting us on the next steps. It's possible the SEC staff will ask us to restructure our proposal as an exemptive order, which would require the approval of the SEC Commission.

We don't have final SEC blessing and this may be a long journey, but we are optimistic we will ultimately achieve success.

As you can tell, we are thrilled with our success at moving the issue forward, although we want to manage your expectations. Thanks again for your enthusiastic support.

# **EXHIBIT 36**

VB-34

From: Joan X Prarie @ IDS on 11/05/98 04:56 PM CST  
To: Rockell Metcalf, Sheri Beck @ IDS, Suzanne Crane @ IDS  
cc:  
Subject: Card Billing Statement Mock Up

Attached are two different Card Billing Statement mock up versions. Each version is comprised of 2 pages - Debits and Credits.

The first version includes each line item, how it looks today for PA and how it will look including both products (where applicable). Line descriptions are included below the table.

The second version includes each line item with the information provided only for brokerage. The tables include line number, field name, field description for Investing on the Card, and field explanation.

Let me know if you want any changes - I could easily do them. My telephone number is 612-678-5309.



SEC IOTC Card Statement Desc

Joan

## Investing On The Card

The table shows the current items listed on the Card Billing Statement and the information that will be used for Investing on the Card for Service Establishment Number 5046690186.

### Debits

Line	Privileged Asset Product	Name	Investing on the
1	January 9, 1997*	Date	January 9, 1997*
2	PRIVILIGED ASSETS MINNEAPOLIS MN	Vendor name	AMER EXP SERV CORP. MINNEA
3	JAN CONTRIBUTION	Contribution period	JAN CONTRIBUTION
4	PRIVILIGED ASSETS	Product name	PRIVILEGED ASSETS - For Privileg Brokerage Account - For Brokerage P
5	CERTIFICATE # 1234567890	Contract/Acct ID#	CERTIFICATE # 1234567890 - For Priv Brokerage Account Number (eight digit of the nine digit number) - For Brokera
6	FOR INQUIRIES CALL 1-800-633-4003	AESC phone #	FOR INQUIRIES CALL 1-800-633-4003 FOR INQUIRIES CALL 1-800-978-9426
7	Reference: 1234567890 Roc Number: 1234567890	Reference numbers	Reference: Derived Roc

### Explanation of Line Items

The Card Statement Billing Format is the general format used for a merchant file. The Service Establishment number and name is the merchant identifier on TRS Systems. AEFA Systems provides a file to TRS for each Card Billing Cycle. The following information is provided on this file.

Line 1 - Date identifies the billing date. The date is the same for all clients Investing on the Card for a particular bill cycle. The Card System has ten bill cycles each month.

Line 2 - American Express Service Corp is the registered broker-dealer. The field length is limited to 20 characters and is abbreviated to read Amer Exp Serv Corp.

Line 3 - Contribution period indicates the billing period; for example, month or quarter. The word "Contribution" implies the payment is voluntary.

Line 4 - Product name is a variable field and identifies the product the Cardmember is being billed for.

Line 5 - Contract/Acct Identification Number is specific to the client. For brokerage clients the identification number is their brokerage account identification number.

Line 6 - AESC telephone number is a 1-800-number the client may call for service issues related to their Amer Exp Serv Corp Card billings. The service areas are staffed with AESC service associate employees. All brokerage related issues are serviced by brokerage service representatives.

Line 7 - These numbers are reference numbers and appear to be derived based on the Contract/Acct ID#.

### Credits - Version 1

Line	Privileged Asset Product	Name	Investing on the
1	January 9, 1997	Date	No Change
2	PRIVILIGED ASSETS ADJUSTMENT	Vendor Name	AMER EXP SERV CORP ADJUSTME

### Credits - Version 2

Line	Privileged Asset Product	Name	Investing on the
1	January 9, 1997	Date	No Change
2	ADJUSTMENT FOR PRIVILIGED ASSETS	Vendor Name	ADJUSTMENT FOR AMER EXP SER

### Explanation of Credits Version 1 and Version 2

Version 1: The first adjustment is made by PA CSO. A selective group within the PA CSO have access to the Card System and have authority to credit the Cardmember's account for adjustments related to their Amer Exp

Serv Corp billings and transactions. These adjustments are made as a result of a customer service call from a client.

Version 2: The second adjustment is generated by the TPNS Script (a TRS system). The TPNS adjustment is made to remove American Express Service Corp amounts "past due" to avoid a Cardmember receiving a late payment notice for this elective payment. The adjustment is made within 60 days of the non-payment. The TPNS adjustment is done through "script" and results in a letter being generated to the Cardmember/Client advising them of a credit in \$xxx.xx being issued to their Card account.

## Investing On The Card

The table describes the information included on the Card Billing Statement for Investing on the Card. The Card Statement Billing Format is the general format used for a merchant file. The Service Establishment number and name is the merchant identifier on TRS Systems. AEFA Systems provides a file to TRS for each Card Billing Cycle.

### Debits

Line	Field Name	Field Description for Investing on the Card	Field
1	Date	January 9, 1997*	Date identifies the billing date Investing on the Card for a pa has ten bill cycles each month
2	Vendor name/location	AMER EXP SERV CORP. MINNEAPOLIS MN	American Express Service Co field length is limited to 20 ch Amer Exp Serv Corp.
3	Contribution period	JAN CONTRIBUTION	Contribution period indicates or quarter. The word "Contri voluntary.
4	Product name	Brokerage Account	Product name is a variable fie Cardmember is being billed f Funds the product name is "b
5	Contract/Acct ID#	Brokerage Account Number (eight digit identifier, first eight digits of the nine digit number)	Contract/Acct Identification N brokerage clients the identific account identification number
6	AESC phone #	FOR INQUIRIES CALL 1-800-978-9426	AESC telephone number is a service issues related to their billings. The service areas ar employees. All brokerage rel service representatives.
7	Reference numbers	Reference: Derived      Roc Number: Derived	These numbers are reference based on the Contract/Acct I



**Credits - Version 1**

Line	Field Name	Field Description for Investing on the Card	Fiel
1	Date	January 9, 1997	Date identifies the date the ad System.
2	Vendor Name	AMER EXP SERV CORP ADJUSTMENT	This adjustment is made by within the Privileged Asset System and have authority account for adjustments rel Service Corp billings and t made as a result of custom

**Credits - Version 2**

Line	Field Name	Field Description for Investing on the Card	Fiel
1	Date	January 9, 1997	Date identifies the date the ad System.
2	Vendor Name	ADJUSTMENT FOR AMER EXP SERV CORP	This adjustment is generate system). The TPNS adjust Express Service Corp amo Cardmember receiving a la payment. The adjustment i non-payment. The TPNS and results in a letter being Cardmember/Client advisi being issued to their Card

# **EXHIBIT 37**

From: Patrice Jacobson <Patrice.Jacobson@aexp.com>  
To: "Hsobelman@swlaw.com" <Hsobelman@swlaw.com>  
Date: 11/10/98 8:20am  
Subject: Investing on the Card

Howard - Hope all is well. Colleen Curran gave the okay to do the search relating to Investing on the Card so please let it roll. Thanks, Patrice  
----- Forwarded by Patrice Jacobson on 11/10/98 10:31 AM  
-----

From: Colleen Curran @ IDS on 11/10/98 09:21 AM CST  
To: Patrice Jacobson  
cc: Rockell Metcalf  
Subject: Investing on the Card

Patrice, this sounds fine to me. Would you let Howard know that is ok? Rockell is starting the work of putting together the response to the patent questionnaire, so you should contact him about that stuff going forward. Thanks.

----- Forwarded by Colleen Curran on 11/10/98 09:11 AM  
-----

Patrice Jacobson @ AMEX  
11/09/98 10:18 AM EST  
To: Colleen Curran  
cc:  
Subject: Investing on the Card

Colleen - I am not sure if you have spoken to Howard Sobelman or Michael Kelly of Snell & Wilmer on this matter. Howard feels that conducting a clearance search should be done for the reason mentioned below. Please let me know as soon as possible if you wish to proceed OR you can contact Howard directly at (602) 382-6228 if you have any additional questions. Either way please let me know if you wish to proceed with a clearance search. Thanks, Patrice

PS - It was great to see you last week!!! You look terrific!!!!  
----- Forwarded by Patrice Jacobson on 11/09/98 10:18 AM  
-----

From: Sobelmh@swlaw.com @ Internet on 11/07/98 12:15 AM MST  
To: Patrice Jacobson  
cc: dmier@swlaw.com @ Internet, mkelly@swlaw.com @ Internet  
Subject: Investing on the Card

Patrice:

I reviewed the materials for "Investing on the Card" and i recommend conducting a clearance search to determine if any third party rights cover any aspects of the system. The clearance search should be around \$3-4,000.

I will not proceed until i receive your approval.

thanks.

Howard

\*\*\*\*\*

Howard I. Sobelman  
Snell & Wilmer L.L.P.  
One Arizona Center  
400 E. Van Buren  
Phoenix, AZ 85004-0001  
(602) 382-6228  
Fax: (602) 382-6070

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# **EXHIBIT 38**

# Snell & Wilmer

L.L.P.  
LAW OFFICES  
One Arizona Center  
Phoenix, Arizona 85004-0001  
(602) 382-6000  
Fax: (602) 382-6070

PHOENIX, ARIZONA

TUCSON, ARIZONA

IRVINE, CALIFORNIA

SALT LAKE CITY, UTAH

Time In 11:28

## FACSIMILE REQUEST FORM

Time Out 11:45

**PLEASE DELIVER THE FOLLOWING MATERIAL AS SOON AS POSSIBLE**

TO: FACSIMILE NUMBER:  
**Robert McCabe 800/357-9995**

TO: FACSIMILE NUMBER:

FROM:

**Howard I. Sobelman**

REMARKS:

**NEW CLEARANCE SEARCH REQUEST**

ORIGINAL DOCUMENT: Will not be sent

**VIA FACSIMILE ONLY**

CONFIRMATION No.:  
(IF REQUIRED)

NUMBER OF PAGES:  
(INCL. COVER PAGE) 3

DATE: November 11, 1998

CLIENT/ MATTER: 10655.0208

PLEASE RETURN TO: Debbie Mier (16s02)

PERSONAL FAX: No

REQUEST/ATTORNEY: Howard I. Sobelman

DIRECT LINE: 602/382-6228

**IF YOU HAVE NOT PROPERLY RECEIVED THIS TELECOPY**

**PLEASE CALL US AT (602) 382-6075**

**OUR FACSIMILE NUMBER IS (602) 382-6070**

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L.L.P.  
LAW OFFICES

One Arizona Center  
Phoenix, Arizona 85004-0001  
(602) 382-6000  
Fax: (602) 382-6070

PHOENIX, ARIZONA

TUCSON, ARIZONA

IRVINE, CALIFORNIA

SALT LAKE CITY, UTAH

Howard I. Sobelman (602) 382-6228  
Patents, Trademarks & Copyrights  
Internet: hsobelman@swlaw.com

November 11, 1998

**VIA FACSIMILE ONLY**

Robert McCabe  
Washington Patent Services Corp.  
Crystal Park III  
2231 Crystal Drive, Suite 500  
Arlington, VA 22202

Re: Clearance Search for "INVESTMENT PAYMENT METHOD"  
Our File No.: 10655.0271

Dear Bob:

Please conduct a clearance (right to use) search for a "Investment Payment Method". I would appreciate receiving the results of this search in my office no later than **November 18, 1998**.

This system includes an existing chargecard system, such as the American Express Chargecard billing system, in which a consumer uses a chargecard to purchase products and then the consumer receives a billing statement at the end of each month including all the charges for that month. The consumer then sends a payment for all the charges for the particular month to the chargecard administrator. Under the improved system, a chargecard holder appoints the chargecard administrator as a processing agent to collect and promptly remit the consumer's voluntary, periodic payments for mutual fund shares or variable annuity products. Prior to beginning the investing arrangement with the chargecard administrator, the consumer notifies the broker of the amount he intends to invest on a monthly basis and the specific funds for the variable annuity selections, including the allocation of investment amounts to each investment. The consumer's intended investment amount is reflected on his chargecard billing statement as a reminder to remit the investment amount along with the normal chargecard payment.

After receiving his statement, the consumer sends a single check for both regular chargecard purchases and for the purchase of investments such as, for example, mutual fund shares. When the consumer payment is received by the chargecard administrator, a payment processing system determines, based on the consumer's

Robert McCabe  
November 11, 1998  
Page 2

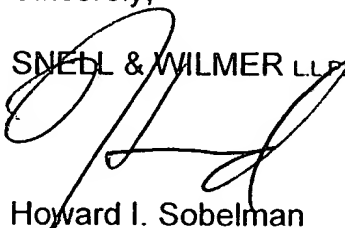
preselected investments, how the consumer's payment should be allocated between regular chargecard payments and investment amounts, then the payment processing system electronically forwards the appropriate investment amount to the broker for investing. The administrator of the chargecard does not hold or control the investment funds because the administrator only handles the funds pursuant to the consumer's directions to transfer the funds.

The price on the consumer's mutual fund shares is computed after receipt of the consumer's order by the broker and sent to the consumer. The consumer may make withdrawals and changes to his brokerage account or terminate participation in the service by calling a toll free number. Since each investment is voluntary, non-payment of the investment amount will not effect the consumer's ability to charge on the chargecard and unpaid investment amounts will not accrue interest or other charges. The consumers are not exposed to any risk of loss by using the chargecard administrator as a processing agent for their intended investment amounts because the chargecard administrator will take full responsibility for the safety of the funds from the time the intended investment amount is received by the chargecard administrator.

**PLEASE CONFIRM RECEIPT OF THIS CLEARANCE SEARCH REQUEST AND THE COMPLETION DEADLINE.** If you have any questions regarding this system or this search, please do not hesitate to call.

Sincerely,

SNELL & WILMER LLP



Howard I. Sobelman

HIS:dm



# **EXHIBIT 39**

# Washington Patent Services Corporation

Professional Patent Searching in the United States Patent and Trademark Office Since 1980

**Toll Free telephone**

1-800-654-7322

Crystal Park III

2231 Crystal Drive - Suite 500

Arlington, VA 22202

**Toll Free facsimile**

1-800-357-9995

E-mail: [searchers@washpat.com](mailto:searchers@washpat.com)

November 17, 1998

Howard I. Sobelman  
Snell & Wilmer, L.L.P.  
One Arizona Center  
Phoenix, Arizona 85004-0001

In re: *SearchPlus* Clearance Search  
Invention: Investment Payment Method  
Your Reference: 10655.0271  
Our Docket: 98276

Dear Mr. Sobelman:

Pursuant to your request, a *SearchPlus* Clearance search has been conducted through the official records and files of the U.S. Patent and Trademark Office. The search was directed to a charge card system that incorporates an investment plan as fully described in your provided disclosure. The search was conducted manually in the Public Search Room and also through selected files in the Examiner Search Rooms. Computer databases were also investigated to assure a thorough search.

## SEARCH AREAS

While numerous subclasses may have been partially investigated, the most relevant search areas included the following class(es)/subclass(es): 705/14; 705/17; 705/35; 705/37; 705/39; and 705/40.

## SEARCH RESULTS

As a result of the utility search, the following U.S. documents, copies of which are provided herewith, were located:

5,787,404- discloses a system in which a credit card is used in conjunction with a retirement fund where an option of making monthly contribution to the fund with the monthly card payment.

**5,761,650-** discloses a system and method of generating billing statements with message inserting and detailed charges incurring over billing cycles.

**5,745,706-** discloses a method for managing an investment and spending account, so as to achieve selected guidelines for spending flexibility and investment returns.

5,717,989   5,483,445   5,262,942   4,823,265   4,751,640  
4,694,397   4,597,046

As a result of the design search, the following U.S. patent documents, copies of which are provided herewith, were located:

No relevant design patents were located.

As a result of the foreign publications search, the following Patent Cooperation Treaty/European Patent Office patent documents, copies of which are provided herewith, were located:

No relevant foreign patents were located.

\*\*\*

Please feel free to contact us if you have any questions regarding the search. Thank you for using our services.

Warm regards,

  
Robert McCabe

# **EXHIBIT 40**

**Snell & Wilmer**  
L.L.P.  
LAW OFFICES

One Arizona Center  
Phoenix, Arizona 85004-0001  
(602) 382-6000  
Fax: (602) 382-6070

PHOENIX, ARIZONA

TUCSON, ARIZONA

IRVINE, CALIFORNIA

SALT LAKE CITY, UTAH

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8021 1372 8867

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Howard I. Sobelman (602) 382-6228  
Patents, Trademarks & Copyrights  
Internet: hsobelman@swlaw.com

December 8, 1998

**VIA FEDERAL EXPRESS**

**ATTORNEY/CLIENT PRIVILEGED**  
**CONFIDENTIAL COMMUNICATION**

Ms. Patrice Jacobson, Manager  
General Counsel's Office  
AMERICAN EXPRESS TRS  
American Express Tower  
World Financial Center  
New York, NY 10285-4900

Re: Investing on the Card  
Our Ref. No.: 10655.0271

Dear Patrice:

Per your request, we have conducted a clearance search for the "Investing on the Card" system. Briefly,

However, this analysis is limited to the TRS Investing On the Card System and does not analyze the services provided by American Express Service Corporation.

In conducting this search and analysis, we relied upon a letter submitted by American Express TRS to the Securities and Exchange Commission dated September 8, 1998 which describes the operation of the Investing On the Card System. In general, the system incorporates the American Express Chargecard billing system, in which a consumer uses a chargecard to purchase products and then the consumer receives a billing statement at the end of each month which includes all of the charges for that month. The consumer then sends a payment for all the charges to American Express. Under the improved system, a cardmember appoints American Express as a processing agent to collect and promptly remit the cardmember's voluntary, periodic payments for mutual fund shares or variable annuity products to American Express Service Corporation (AESC) which is a registered broker-dealer who distributes various investment products.

# **EXHIBIT 41**



January 6, 1999

American Express  
General Counsel's Office  
World Financial Center  
New York, NY 10285-4900

Howard I. Sobelman, Esq.  
Snell & Wilmer  
One Arizona Center  
Phoenix, Arizona 85004-0001



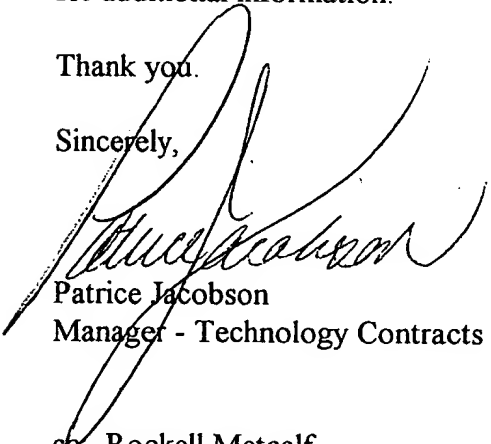
RE: Investing on the Card

Dear Howard:

Attached please find a completed Patent Checklist form along with a completed New Invention Disclosure form. Please review and let me know if you have any questions. If necessary, feel free to contact Rockell Metcalf of the General Counsel's Office here in New York at (212) 640-5760 for additional information.

Thank you.

Sincerely,

  
Patrice Jacobson  
Manager - Technology Contracts

cc. Rockell Metcalf

Attachments

# **EXHIBIT 42**



American Express Company  
American Express Tower  
World Financial Center  
New York, New York 10285



January 11, 1999

Mr. Stephen J. Steichen  
Senior Vice President - Finpro  
J&H Marsh and McLennan  
333 South 7<sup>th</sup> Street, Suite 1600  
Minneapolis, MN 55402-2400

Dear Steve,

Thank you and Ted for continuing to work diligently on the TRS surety need.  
Attached is four copies of:

- American Express Company 1997 Annual reports
- American Express Company third quarter 10q reports

We are still working on obtaining TRS Audited Financials for year ended 1997. We expect to have them to you by Wednesday, January 13, 1999.

Please call me if you need other information from me. My understanding is that Rockell Metcalf, Esquire, is sending a copy of the no action request letter to your attention and you are sending the following information to Rockell and myself...

- Copy of regulation governing banks for 401K money they are in custody of prior to investing it (2 items).
- Copy of bond forms that are applicable

On Friday January 15 Ted and Rockell and yourself are meeting at Rockell's Minneapolis office (IDS Tower Floor 27) to finalize the bond form wording. After the meeting we will need to discuss and agree on the next steps.

Very truly yours,

A handwritten signature in cursive script that reads "Andrew E. Nottestad".

Andrew E. Nottestad

cc R. Metcalf  
K. Gee

# **EXHIBIT 43**

American Express  
7<sup>th</sup> Avenue South  
Minneapolis, MN



## MEMORANDUM

Date: March 5, 1999

City: Minneapolis

Office: Minneapolis, MN

Phone: (612) 678-1343  
E-Mail: Nancy Simmons

**SUBJECT:** Request for Approval of Project Definition Report  
Invest on the Card Point of Arrival

Project ID #: P0030627

**TO:** Invest on the Card Project Team

**FROM:** Nancy Simmons

Attached is the Project Definition Report (PDR) for the Invest on the Card Point of Arrival project.

This document is intended for sign off by the designated signatories. Please review the document for accuracy and forward your approval and/or comments to me by March 15, 1999. Only the sign off pages need be returned to me. Once the signatures are received, we will conclude the Project Definition Phase and continue with the Analysis Phase.

If you have any questions or concerns, please contact me at the above number.

Nancy Simmons  
IOTC-POA Project Manager



# Invest on the Card Point of Arrival Project Definition Report

*Project ID# P0030627*

**FINAL DRAFT**

---

Date Published:	02/16/99
Date Revised:	03/04/99

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Development Contract Number:	Date Created:	January, 1999
Project Name:	Investing on the Card - POA	
Project MR Unit:	5123	

# **EXHIBIT 44**



American Express Financial Advisors Inc.  
IDS Tower 10  
Minneapolis, Minnesota 55440

Financial  
Advisors

# Facsimile Cover Sheet

Date 4-16  
Pages, including cover sheet: 11

To: Howard Silverman

From:

- ☐ Nancy Jones (612) 671-4671
  - ☐ Jeni Hofstede-Bryan (612) 671-1348
  - ☐ Joel Allen (612) 671-4693
  - ☐ Barbara Norrgard (612) 671-2689
  - ☒ Suzanne Crane (612) 671-3741
  - ☐ Spencer Segal (612) 678-2174
  - ☐ Mark Moller (612) 671-0717
  - ☐ Yedda Marks (612) 678-1359
  - ☐ Marty Anderson (612) 671-1890
  - ☐ Arvind Sharma (612) 678-1363
  - ☐ Eric Havir (612) 671-2542
  - ☐ Tamara Parrilli (612) 678-2360
  - ☐ Howard Weinberger (612) 678-1333
  - ☐ Sally Cooper (612) 671-6293
  - ☐ George Lawton (612) 671-6956
  - ☐ Marcy Keckler (612) 671-4195
- Fax Number (612) 671-0505

Phone: 602-382-6228

Fax Number: 602-382-6228

CC: 6070

Remarks: ☐ Urgent ☐ Confidential ☐ Reply ASAP ☒ For Your Review ☐ Please Comment

The additional TDC documents  
are discussed today.

If you did not receive all pages, please call (612) 671-1348. Thank you!



# Investing on the Card: Mutual Funds Receive Cardmember Remittance

P. 08

FAX NO. 6128710505

APR-16-99 FRI 02:23 PM AMERICAN EXPRESS

L:\MESS\PROJECTS\acc\analyze\line of visibility\Business Models.vsd

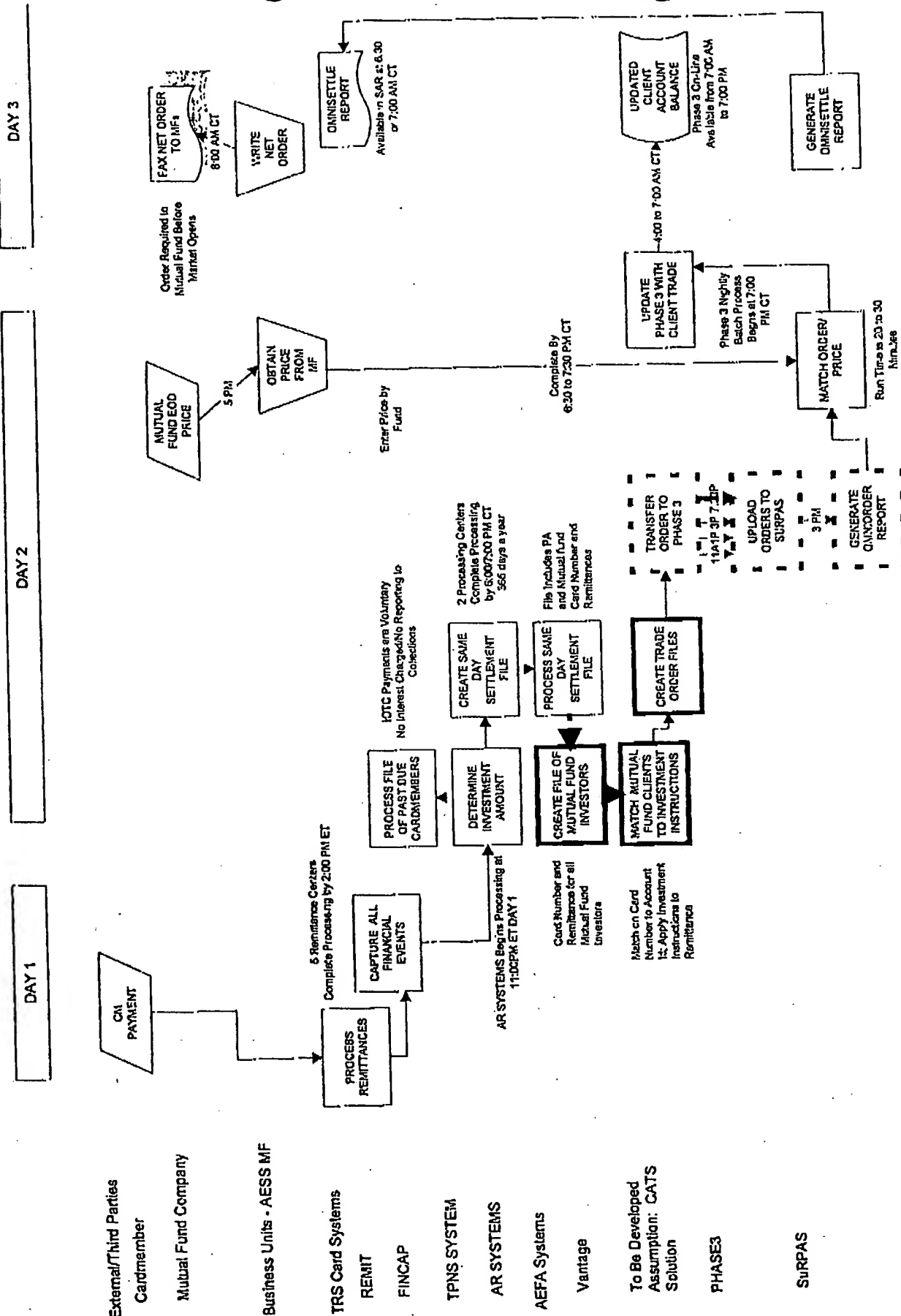


Figure 5

# **EXHIBIT 45**

From: HOWARD SOBELMAN  
To: inet:suzanne.crane@aexp.com  
Date: 4/21/99 5:05pm  
Subject: IOTC patent

page 54, PA functionality flow diagram, step 11.5  
-- what is a savings balance? does it just store the amount billed to a cardmember?

IOTC: Mutual Funds....Bill Cardmember Flowchart  
-- what does ROC, CAP and PREMIUM BILLING "TRANS REG" each stand for?

thx.....

\*\*\*\*\*

Howard I. Sobelman, Esq.  
SNELL & WILMER L.L.P.  
One Arizona Center  
400 E. Van Buren  
Phoenix, AZ 85004-0001  
(602) 382-6228  
Fax (602) 382-6070

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# **EXHIBIT 46**

**From:** Suzanne Crane <Suzanne.Crane@aexp.com>  
**To:** "Sobelmh%swlaw.com" <Sobelmh@swlaw.com>  
**Date:** 4/28/99 9:10am  
**Subject:** Re: IOTC patent

Howard, I just learned more about the Vantage system on an IOTC meeting for Triumph that want to make sure your aware of.

Vantage is a vendor product. We manipulate the code, but if we create a new "modual" they find useful, they apparently can take it and sell it off. We share in the proceeds if they do. For the market test effort, Vantage will be adding the funcitonality of "splitting" the file from TRS, sending the non-PA accounts to the new CATS screen.

In addition, we are wrapping up our conceptual design for the Triumph system (new card system). We are on track for an April 2000 implementation of IOTC on the Triumph system. To be on the new card system, the Card is building a new module for "non-financial" billing...or billing that does not become a card member obligation to pay. AEFA will be building or truely expanding the exisiting CATS sytem to handle multiple AEFA product billings to one Card. Currently, we can only bill on a one to one ratio.

I want to point this out because I want to make sure your aware of the whole picture. The intial form was market test info only, with references to the fact we were in the process of working with Triumph to get on the agenda and have an additional effort in 1999.

**CC:** Rockell Metcalf <Rockell.Metcalf@aexp.com>

From: Suzanne Crane <Suzanne.Crane@aexp.com>  
To: "Sobelmh%swlaw.com" <Sobelmh@swlaw.com>  
Date: 4/28/99 8:23am  
Subject: Re: IOTC patent

I apologize for the delay. Your questions:

page 54, PA functionality flow diagram, step 11.5

-- what is a savings balance? does it just store the amount billed to a cardmember?

Response: Savings balance refers to the "PA or IOTC" balance on the card. It includes the Billed, Received, and Outstanding amounts. The term savings balance is used because PA was launched under "Savings on the Card"

IOTC: Mutual Funds....Bill Cardmember Flowchart

-- what does ROC, CAP and PREMIUM BILLING "TRANS REG" each stand for?

1. On the card statement ROC refers to Record Of Charge

2. Premium Billing Tran Reg refers to American Express Premium Billing Transmittal Register

( A report that Provides a Summary by CAP Number and SE Number of Number of Records and Amounts

Included for Billing for Each Billing Cycle.)

3. CAP--

Service Establishment (S/E) number:

This number identifies an individual establishment that services a card member

- eg: Dayton,s downtown Mpls store

TRS also calls this a Merchant Number.

Primarily used throughout the TRS systems for grouping and reporting

Central Affiliated Property (CAP) number:

This number is similar to an S/E number, but it identifies the overall company

- eg: Dayton Hudson Company

Relationship between CAP numbers and S/E numbers:

TRS maintains the relationship within their file of S/E numbers as cross references

S/E numbers sometimes equal CAP numbers. They are most likely to equal in the events of:

- Only one service establishment for the overall company

- The main headquarters service establishment of the overall company (eg: Dayton,s Mpls)

Preference is to not use the same number for both (for clarity)

Use of CAP numbers:

- In the Card billing process only.

- S/E Payable

Use of S/E numbers:

- In the Card Billing process.
    - Vantage (and soon to be CATS too)
    - FINCAP
    - AR/Billing
    - S/E Payable
    - TPNS Script
  - In the Card Remittance process.
    - REMIT
    - FINCAP
    - Savings Balance File
    - AR/???
    - TPNS Script
    - Same Day Settlement File
- QUEST: What other systems? (Review Joan,s diagrams, ask

Terry)

.thx.....

# **EXHIBIT 47**



From: Suzanne Crane <Suzanne.Crane@aexp.com>  
To: "SOBELMH%swlaw.com" <Sobelmh@swlaw.com>  
Date: 4/28/99 9:15am  
Subject: Re: PDR

Howard, for your reference and reading pleasure. Here is the PDR for the 1999 IOTC development effort. The flow charts you have still apply, but some of the system (i.e. Card legacy to Triumph) will change.  
----- Forwarded by Suzanne Crane on 04/28/99 11:01 AM  
-----

Nancy L Simmons  
04/09/99 09:41 AM  
To: Suzanne Crane @ AMEX  
cc:  
Subject: Re: PDR

----- Forwarded by Nancy L Simmons on 04/09/99 09:48 AM  
-----

Suzanne Crane  
04/09/99 09:45 AM  
To: Nancy L Simmons@AMEX  
cc:  
Subject: Re: PDR

Looks good. Can you send me the most recent version. I will have take to NY and get signatures/review if needed there. I don't think we really need official sign off from them, but we need to figure out how to secure technology resources. Anyways, I'll take the PDR and give them copies if they desire and discuss the overall process with them.

# **EXHIBIT 48**

# Snell & Wilmer

L.L.P.  
LAW OFFICES

One Arizona Center  
Phoenix, Arizona 85004-0001  
(602) 382-6000  
Fax: (602) 382-6070

PHOENIX, ARIZONA

TUCSON, ARIZONA

IRVINE, CALIFORNIA

SALT LAKE CITY, UTAH

Howard I. Sobelman (602) 382-6228

Patents, Trademarks & Copyrights

Internet: hsobelman@swlaw.com

April 30, 1999

## VIA FEDERAL EXPRESS

**FedEx**

8115	6597	2287	Form ID. No. 0205
------	------	------	-------------------------

FedEx Tracking Number — PULL UP PURPLE TAB

Suzanne Crane  
AMERICAN EXPRESS FINANCIAL ADVISORS INC.  
IDS Tower 10  
Minneapolis, MN 55440

Re: Title: SYSTEM AND METHOD FOR DIVIDING A  
REMITTANCE AND DISTRIBUTING A  
PORTION OF THE FUNDS TO MULTIPLE  
INVESTMENT PRODUCTS  
Our Docket No.: 10655.7700

Dear Suzanne:

I am enclosing a draft of the subject patent application for your review. Please read over the entire application very carefully to ensure that it provides a technically accurate and complete description of the invention. The description should be sufficiently complete to enable someone of ordinary skill in the art (e.g., the average practitioner in the technological field of the invention) to make and use the invention. Additionally, please ensure that the best mode of the invention, as you now know it, is disclosed.

After you have reviewed the enclosed draft, please contact me so that we may discuss any comments, changes and/or additions you may have to the application.

Sincerely,

SNELL & WILMER, L.L.P.

Howard I. Sobelman

HIS:dm  
Enclosure

cc: Rockell Metcalf (via facsimile w/o encl.)  
Robert Miller (via facsimile w/o encl.)  
Patrice Jacobson (via facsimile w/o encl.)

Sobelman\PHX\656716.01

# **EXHIBIT 49**

[Click here and type address]

## facsimile transmittal

✓ To: Howard Sobelman

Fax: 602-382-6070

Snell &amp; Wilmer

To: Rockell Metcalf AEFA, NY

Fax: 619-

From: Suzanne ~~Crane~~

Date: 05/27/99

612 671-3241

Re: Patent forms for IOTC

Pages: 32

CC: [Click here and type name]

☐ Urgent☒ For Review☐ Please Comment☐ Please Reply☐ Please Recycle

I promised a completed review...but we are ALMOST done...made it to page 21, and will send the remainder next week. I'm sending what we have as a starter. There is confusion over the "billing" system, and we've made notes and sent 5 other process flows to make sure we've given you all the correct information.

Please add: Mark Sweazy to the Inventors List. Mark is also a good contact for you to check in with Howard if you have really really technical questions. His phone number is 612-671-8921. I'm working from home Friday, but please feel free to call 612-535-9877.

Trade Database 30 left in b/c documents describe its function  
& changed to optional feature  
suitably obtains/transmits includes manual or auto

# **EXHIBIT 50**

10655.7700

From: Howard Sobelman  
To: inet:suzanne.crane@aexp.com, inet:rockell.metcalfe@...  
Date: 10/5/99 10:50am  
Subject: IOTC revised patent application

Suzanne:

As discussed, please review the revised draft and let me know if we need to use the new flowcharts. Also, we previously discussed that AMEX will be filing for copyright registration for the code. Has AMEX completed the filing?

As planned, we will discuss your comments tomorrow at 11am (MN time).....thx

<WP Attachment Enclosed>

\*\*\*\*\*

Howard I. Sobelman, Esq.  
SNELL & WILMER L.L.P.  
One Arizona Center  
400 E. Van Buren  
Phoenix, AZ 85004-0001  
(602) 382-6228  
Fax (602) 382-6070

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CC: mierd

# **EXHIBIT 51**



**From:** Howard Sobelman  
**To:** mied  
**Date:** 10/11/99 8:32am  
**Subject:** Addresses -Forwarded

please prepare all documents and fax out early as possible today and request  
fax signatures back.....

From: "Suzanne Crane" <Suzanne.Crane@aexp.com>  
To: "SOBELMH@swlaw.com" <SOBELMH@swlaw.com>  
Date: 10/11/99 6:32am  
Subject: Addresses

Here ya go!

Suzanne P Crane  
5249 Pennsylvania Ave N  
New Hope MN 55428

Marcus Sheire  
1540 Osceola Ave  
St Paul, MN 55105

Mark D Sweazy  
11219 South Oakvale Road  
Minnetonka, MN 55305

Bonnie Schlegel  
543 84th Circle NW  
Coon Rapids, MN 55333

Joan is the consultant, so we are sending both her work and home address incase you need them.

Home: Joan Prairie  
2715 West 28th Street  
Minneapolis, MN 55416

Work: Joan Prairie  
4620 West 77th Street  
Edina, MN 55435-4978

From: "Suzanne Crane" <Suzanne.Crane@aexp.com>  
To: "SOBELMH@swlaw.com" <SOBELMH@swlaw.com>  
Date: 10/11/99 6:25am  
Subject: Re: IOTC revised patent application -Reply

I'm sorry. Our server went down and I was unable to get on Friday.

1. I have the addresses as of this morning and will email them ASAP.
2. You have all the comments. Mark Sweazy is the only other person with comments, he sent you a long note. I think the rest of us were ok with your interpretation of the data entity diagram, because we were viewing it a more general business level...the idea vs the detailed technical flow. Mark is a systems designer and concerned about the legal ramifications if it is incorrect and later someone challenges. (not that I'm not concerned with, but I read the patent differently than him!)
3. I'll forward Rockell a readable version of the patent for our computers.

----- Forwarded by Suzanne Crane on 10/11/99 08:05 AM -----

SOBELMH@swlaw.com@Internet  
10/08/99 10:20 AM  
To: Suzanne Crane@AMEX  
cc: Rockell Metcalf@MailHub1  
Subject: Re: IOTC revised patent application -Reply

please let me know when i have received all of the comments (i do not know how many people are reviewing the document).....i cannot finalize the declarations, etc. until i fully edit the document because after the declarations are signed, we cannot make any more changes.....thx

\*\*\*\*\*  
Howard I. Sobelman, Esq.  
SNELL & WILMER L.L.P.  
One Arizona Center  
400 E. Van Buren  
Phoenix, AZ 85004-0001  
(602) 382-6228  
Fax (602) 382-6070

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>>> "Suzanne Crane" <Suzanne.Crane@aexp.com> 10/08/99 08:10am

>>>

I'm still awaiting two addresses, I'll send the asap when I get them all. I instructed people to send comments directly to you Howard via Notes and copy me to save time. I reminded them this morning to do this TODAY!! And to confirm if they had no comments, which I expect from two of the people.

Rockell, Howard has my comments so you can give it a read now if you feel. I can't tell how much comments the other people are going to have. They had a lot the first time, but Howard did a great job adjusting for them.

CC: "Rockell Metcalf" <Rockell.Metcalf@aexp.com>

106SS.7760

From: Howard Sobelman  
To: I-Mail.SMTP("Mark.D.Sweazy@aexp.com")  
Date: 10/8/99 3:54pm  
Subject: Comments on IOTC Patent Application -Reply

thx for the comments. unfortunately, when i started drafting the application, those are the only figures that existed. I would like to have a teleconference with you on Mon or Tues so i can explain the reasons certain sections are drafted in certain ways and discuss your edits....

i am NOT available:  
Mon 130-2 (AZ time)  
Tues 9-2 (AZ time)

Let me know what works for you.....

thx

\*\*\*\*\*

Howard I. Sobelman, Esq.  
SNELL & WILMER L.L.P.  
One Arizona Center  
400 E. Van Buren  
Phoenix, AZ 85004-0001  
(602) 382-6228  
Fax (602) 382-6070

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CC: mierd

From: "Mark D Sweazy" <Mark.D.Sweazy@aexp.com>  
To: "Sobelmh%swlaw.com" <Sobelmh@swlaw.com>  
Date: 10/8/99 3:41pm  
Subject: Comments on IOTC Patent Application

I'm sorry for the late response, but I've been struggling with this as you'll see below. After you read my notes, please contact me and let me know how I can help get this done in the quickest and least painful manner. I'd be happy to block off a chunk of next week to work on this if that is what is needed.

There are a lot of ways to describe these functions and the systems that support them, including process flows, system diagrams, and logical data models. Unfortunately, describing them in terms of a patent application is new to me and I'm having trouble differentiating between what might be an error versus what is the normal way of describing something in the patent world. So, I'll do the best I can given my ignorance. Here are my main 2 concerns:

First, I'm still having trouble with the accuracy and clarity of the diagrams that get referred to so much in the text. In particular, I'm uncomfortable with how we are describing physical constructs (databases, etc) while referring to a logical data model. In many cases, the logical entities shown as rectangles on figure 2 are subsequently being referred to as physical databases, when in fact some of them are not. In fact, the very nature of logical data models means that you can have an entire page of data constructs and their relationships to each other that otherwise might translate into a single database. I believe this is the case with figure 2. Originally, it was meant to describe only data held and used at AEFA, primarily in the investment instructions database. The references to billing and remittance info, 16 & 18, were to show that they were part of the overall investment instructions set of data. If we are now going to use the diagram in a different way, I think it needs a few modifications.

Second, I don't know how picky I should be. That is, what are the chances that this patent will wind up as evidence in a patent infringement lawsuit? If there is any reasonable chance of that, and if any of the language or diagrams used in the patent application are not up to the level where they could be successfully defended, then I am even more uncomfortable with signing off on it considering that I might have missed something due to my inexperience with patent language or expectations.

Here are my notes:

1) When I look at Figure 2, I see #22, Investment Instructions, as the CATS arrangement database and the part of Vantage that performs a similar function, and I see #26, Investment Account, as our product accounting systems (further detailed by #s 42, 44, and 46). If my view is accurate, then there are several places in the document that incorrectly refer to #26 as the 'investment account arrangement database'. The term 'arrangement' should only be used in the context of #22, and references to #26 should only be made when

describing the actual client account investments. In fact, the term 'investment instructions' can pretty much replace the term 'arrangement' throughout the document, if so desired. In addition, we may need to re-draw the diagram to remove this 'extra' component ( #26). Some of the following comments will be related to this observation.

2) On page 7, refer to the last full sentence, 'and/or to the investment account arrangement database 26 to purchase investment products (step 220)'. Shouldn't this say 'and/or to the Investment Broker System 20' instead?

3) On page 11, in the center paragraph, the second and third sentences, where it is describing Investment System 20. To me, Investment Broker System 20 is basically everything here at AEFA except for Marketing 48, including the product accounting systems. However, the first sentence just mentions CATS and Vantage. Since the third sentence more accurately describes all of the different components, could the second sentence be deleted? And last but not least, there really is no investment account database, only several different product accounting system databases.

4) On page 12, the center paragraph doesn't make sense to me given the last sentence of comment number 3 above.

5) On page 12, the last paragraph that continues into page 13 does not make sense to me. The diagram originally was meant to show that the investment instructions database 22 could be used to pull off data for marketing 32, trade instructions within an IMA account (30), and product information (34). There may very well be separate marketing and product information databases, but if there is such a thing as a trade information database 30, it would be the brokerage accounting system itself.

6) On page 15, in the top paragraph, beginning with 'wherein the number in the tenth...', since the only billing frequency available to a client is monthly, the 10th digit only tells us which of the monthly cycles to use. It does not communicate any other billing frequency.

7) On page 15, bottom paragraph, and continuing into the next (middle) paragraph on page 16, it seems to get a little repetitious while describing figure 4. At that point we have already transmitted a file of billing records

to the card system and the card system has already printed the bill (first paragraph on page 15). To me, the key point of figure 4 is that at the same time that we send a billing file to the card system, we also send them an extract file to satisfy the 'Chicago Remittance' requirement, whereby all remittance envelopes for card members participating in this offering have a Chicago return address. This card function is performed in the 'TRS Billing Consolidator Process', also shown on figure 1. Maybe we could dispense with figure 4 altogether and include the Chicago Remittance description with the prior paragraph, or not at all.

8) On page 20, last paragraph, second sentence. I believe this should refer to the investment instructions database 22 instead of investment account 26. The 3rd sentence is accurate, but the 4th and 5th sentences, plus all of pages 21 and 22 seem to give more detail about sentence numbers 2 and 3.

This

should be re-worded/re-ordered to be more clear (and the last sentence is misleading and can be deleted since it is covered elsewhere).. Part of the problem might be that diagrams 5 and 6 overlap a little. For example, #518 = #602, etc. It would be more clear if these 2 diagrams could be combined to show the entire remittance process.

9) For the bulk of pages 20 through 24, where references are made to the diagrams, I believe they should be re-worded after we decide how to address my concerns with the diagrams. There are many misleading references to the investment account database 26 that need to be adjusted, as well as some references to the investment broker system 20.

10) On page 27, near the bottom, the broker system components needs re-wording per my prior comments.

11) On page 28, under #6, the description of an 'arrangement' database needs adjusting (I'm assuming that we would prefer to use the term 'investment instructions' rather than 'arrangement').

12) On page 30, first sentence, clarify what is included in the investment broker system. Also, the last sentence should probably refer to the investment broker system rather than the investment account arrangement database.

CC: "Suzanne Crane" <Suzanne.Crane@aexp.com>



10655:7706

From: Howard Sobelman  
To: I-Mail.SMTP("Suzanne.Crane@aexp.com")  
Date: 10/8/99 8:18am  
Subject: Re: IOTC revised patent application -Reply

please let me know when i have received all of the comments (i do not know how many people are reviewing the document).....i cannot finalize the declarations, etc. until i fully edit the document because after the declarations are signed, we cannot make any more changes.....thx

\*\*\*\*\*

Howard I. Sobelman, Esq.  
SNELL & WILMER L.L.P.  
One Arizona Center  
400 E. Van Buren  
Phoenix, AZ 85004-0001  
(602) 382-6228  
Fax (602) 382-6070

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>>> "Suzanne Crane" <Suzanne.Crane@aexp.com> 10/08/99 08:10am >>>  
I'm still awaiting two addresses, I'll send the asap when I get them all. I instructed people to send comments directly to you Howard via Notes and copy me to save time. I reminded them this morning to do this TODAY!! And to confirm if they had no comments, which I expect from two of the people.

Rockell, Howard has my comments so you can give it a read now if you feel. I can't tell how much comments the other people are going to have. They had a lot the first time, but Howard did a great job adjusting for them.

CC: I-Mail.SMTP("Rockell.Metcalf@aexp.com"),

# **EXHIBIT 52**

From: "Rockell Metcalf" <Rockell.Metcalf@aexp.com>  
To: "SOBELMH@swlaw.com" <SOBELMH@swlaw.com>  
Date: 10/12/99 11:14am  
Subject: Re: IOTC -Reply

7700

I now have comments from the Card lawyer. Please call. (212)640-5760.  
Thanks.

CC: "dmier@swlaw.com" <dmier@swlaw.com>, "Suzanne Cran...

From: Howard Sobelman  
To: PHXDOM.PHX34 (MIERD), I-Mail.SMTP("Rockell.Metcalf@...  
Date: 10/12/99 8:27am  
Subject: Re: IOTC -Reply

if you have any changes, please let me know asap.....Suzanne has all of the legal documents which cannot be signed until all changes are input into the document.....thx

>>> "Rockell Metcalf" <Rockell.Metcalf@aexp.com> 10/12/99 06:38am >>>  
Thanks, Howard. I'll call you today to discuss some final legal comments. I'm going to get final comments from the Card lawyer today. I don't expect them to be extensive.

From: dmier@swlaw.com@Internet on 10/11/99 05:45 PM MST  
To: Rockell Metcalf@AMEX, Suzanne Crane@MailHub1  
cc: sobelmh@swlaw.com@Internet  
Subject: IOTC

Attached to this email is the revised patent application which incorporates Mark Sweazy's comments. I am faxing the required documents for you to sign and a revised Figure 2.

The only figure change is Figure 2 wherein the billing info 16 reports directly to investment instructions 22. Also, original 26 and 40 is deleted and investment account is now 40. Most of the changes to the text reflect the changes to Figure 2....

\*\*\*\*\*

Deborah A. Mier  
SNELL & WILMER L.L.P.  
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Phoenix, AZ 85004-0001  
602/382-6123  
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CC: I-Mail.SMTP("Suzanne.Crane@aexp.com"),

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